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Audit Case Number	96-PH-241-1016

TO: Joyce Gaskins, Director, Office of Community
Planning and Development, 3AD

FROM: Edward F. Momorella, District Inspector General
for Audit, Mid-Atlantic, 3AGA

SUBJECT: Department of Housing Services
County of Montgomery
Norristown, Pennsylvania

We performed an audit of the Montgomery County Department of Housing Services (Grantee). The purpose of the audit was to determine if the Grantee administered its HUD-funded residential rehabilitation programs economically, effectively and in compliance with applicable regulations and requirements, and with the terms and conditions of HUD grant agreements.

The audit disclosed that the Grantee needs to revise and strengthen procedures regarding inspections of completed rehabilitation work, conflicts of interest, rehabilitation costs, procurement of supplies and services, rents and occupancy, annual inspections, and contractors' liability insurance coverage.

Within 60 days please give us, for each recommendation made in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Richard J. DeCarlo, Assistant District Inspector General for Audit, at (215) 656-3401.

Executive Summary

We performed an audit of the Montgomery County Department of Housing Services (Grantee) to determine whether the Grantee administered its HUD-funded residential rehabilitation programs economically, effectively and in compliance with applicable regulations and requirements, and with the terms and conditions of HUD grant agreements.

Specific objectives were to determine whether the Grantee: (1) assured that rehabilitation work was completed in accordance with its specifications and work write-ups; (2) verified that properties met Section 8 Housing Quality Standards (HQS) and/or local codes after rehabilitation; (3) obtained the documentation necessary to assure that rehabilitation costs were fully supported and reasonable; (4) complied with applicable procurement requirements for purchasing supplies and services; (5) ensured that rehabilitated rental properties were rented to low-and moderate-income families at affordable rents; (6) determined that homeowners who received assistance in rehabilitating their properties were eligible; and, (7) properly credited program income to the applicable HUD program.

On the basis of our testing, we found that homeowners who received assistance in rehabilitating their properties were generally eligible and program income was properly credited to the applicable HUD programs. However, we found serious problems in the other areas of the Grantee's administration of its HUD-funded residential rehabilitation programs.

This report contains seven findings which detail the following deficiencies:

Repair Work Not Completed and Substandard Conditions Not Corrected

- The Grantee did not ensure that contractors completed all work specified in the rehabilitation work write-ups, due to weaknesses in the system for performing inspections before and after rehabilitation, and in supervising the performance of the inspectors. As a result, 903 work items, with an estimated cost of \$138,347, were not completed or were not completed in a workmanlike manner in 38 of the 39 properties which we inspected. In addition, existing substandard housing conditions were not always corrected, and rehabilitated properties did not meet HQS and/or local codes in 33 of the 39 properties inspected.

Conflicts of Interest

- There were apparent conflicts of interest involving Grantee and subgrantee personnel, because of oversight, lack of understanding as to the transactions and conditions that constitute conflicts of interest, and disregard for the requirements, thereby diminishing public confidence in the objectivity of Grantee and subgrantee staff responsible for administering HUD funds.

Rehabilitation Costs Not Reasonable

- The Grantee did not obtain required cost documentation from rental property owners who performed rehabilitation work on their own properties. Instead, the Grantee reimbursed these owners on the basis of cost estimates which, in many instances, were inflated. As a consequence, the Grantee could not ensure the reasonableness of costs and may have misspent a substantial amount of HUD funds.

Procurement Requirements Not Followed

- The Grantee did not always obtain price quotations from an adequate number of sources, publicly advertise invitations for sealed bids or buy from the lowest priced vendor, as required when purchasing construction supplies and services for use in its Owner Occupied rehabilitation program. The Grantee also paid contractors for certain services even though the contractors had actually provided price quotes for other services. As a result, there was no assurance that the lowest price was obtained for over \$234,000 in supplies and services purchased during the audit period.

Benefits to Low-and Moderate-Income Persons Not Assured

- The Grantee did not ensure that low-and moderate-income persons benefited from the Rental Rehabilitation Program, as required, because the Grantee did not obtain the necessary documentation from property owners to verify that rents were affordable and tenants were qualified. In addition, we noted that four tenants who paid their own utilities were overcharged for their monthly rent.

Rehabilitated Rental
Units Not Inspected
Annually

- Because the Grantee did not maintain and update a complete list of rental properties to be inspected; coordinate with the Montgomery County Housing Authority; or, adequately supervise the responsible inspector, many of the required annual property inspections were not performed. As a result, there was no assurance that rental units were maintained in a decent, safe and sanitary condition after rehabilitation.

Documentation Verifying
Contractors' Liability
Insurance Not Obtained

- The Grantee did not obtain documentation that participating contractors had liability insurance coverage. The Grantee, therefore, had no assurance, in many cases, that it was adequately protected if the actions of contractors resulted in property damage or personal injuries.

Because the foregoing deficiencies call into question the Grantee's ability to properly administer its HUD-funded residential rehabilitation programs, we have provided recommendations for corrective action, which will assist the Grantee in complying with all requirements while providing the much-needed housing rehabilitation assistance to Montgomery County residents.

Recommendations

We recommended that you direct the Grantee to:

- Require the contractors to reimburse the HUD-funded programs for the work not done or not done in an acceptable manner; reinspect all the rehabilitated properties; develop a plan for correcting HQS deficiencies; and implement and improve systems for performing and documenting supervisory and HQS/housing code inspections.
- Implement additional procedures to detect and prevent conflicts of interest involving Grantee and subgrantee personnel.

- Obtain supporting documentation for costs incurred by rental property owners who perform their own work and reimburse such owners only on the basis of actual costs and reasonable overhead and profit, and develop cost estimates on the basis of actual prices charged by local vendors.
- Implement written procurement procedures for its HUD-funded activities that reflect HUD, State and local requirements.
- Implement procedures to verify tenant income, utility allowances and rents, to ensure that rehabilitated units are occupied by low-and moderate-income tenants and that rents are affordable.
- Strengthen procedures for scheduling and carrying out annual inspections of rehabilitated properties.
- Strengthen the system for ensuring that contractors submit evidence of liability insurance coverage.

Auditee Comments

We discussed the draft findings with Grantee staff during the audit and, where appropriate, incorporated their comments into the findings. Written comments provided at the conclusion of our field audit were also incorporated into the findings, where appropriate.

We discussed the draft findings with the Montgomery County Board of Commissioners during an exit conference held on May 7, 1996. The Commissioners expressed their concerns regarding the seriousness of the problems and their willingness to work with HUD staff in order to correct the problems and improve the HUD-funded property rehabilitation programs for the benefit of Montgomery County residents. They also discussed specific actions which were being implemented to address our recommendations.

On May 10, 1996 a letter from the Montgomery County Solicitor, on behalf of the Commissioners, summarized their position regarding the findings and recommendations (Appendix E).

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Abbreviations

CDBG - Community Development Block Grant
CFR - Code of Federal Regulations
HOME - HOME Investment Partnerships Program
HQS - Housing Quality Standards
HUD - U.S. Department of Housing and Urban Development
OIG - Office of Inspector General
RRP - Rental Rehabilitation Program

Introduction

The Montgomery County Department of Housing Services administers the HUD Community Development Block Grant (CDBG), the HOME Investment Partnerships (HOME), and the Emergency Shelter Grant (ESG) Programs. CDBG funds are used for a variety of activities such as public facilities and improvements, and residential rehabilitation administered through subrecipients. CDBG and HOME funds are also used for residential rehabilitation programs administered directly by the Grantee. Emergency Shelter Grants fund rehabilitation, conversion and operating costs of buildings used as emergency shelters for the homeless. The Grantee was allocated the following amounts for these programs in three recent program years:

<u>Year</u>	<u>CDBG</u>	<u>HOME</u>	<u>ESG</u>
1992	\$ 3,467,000	\$ 0	\$ 75,000
1993	3,767,000	1,268,000	51,000
1994	<u>4,089,000</u>	<u>1,017,000</u>	<u>110,000</u>
Totals	<u>\$11,323,000</u>	<u>\$2,285,000</u>	<u>\$236,000</u>

Montgomery County is governed by a three-member Board of Commissioners. Mr. Mario Mele is Chairman. Mr. Robert E. Wright, Sr. was the Director of the Department of Housing Services until April 23, 1996. On May 2, 1996 the Montgomery County Commissioners engaged a consultant, Mr. Gerald Nugent, to oversee the County's housing and community development programs. Grantee records are maintained at One Montgomery Plaza, Suite 508, Airy and Swede Streets, Norristown, Pennsylvania.

The HUD-funded residential rehabilitation programs administered directly by the Grantee are detailed below.

Rental Rehabilitation Program

This program provides financial assistance in the form of deferred payment loans forgiven in equal installments over a ten-year period for the repair and rehabilitation of rental properties. The maximum subsidy per unit is as follows:

<u>Unit Size</u>	<u>Amount</u>
Efficiency	\$ 7,000
1 Bedroom	13,000
2 Bedroom	15,500
3 Bedroom	17,000
4 Bedroom	20,000

Each loan must be matched by the owner. Costs that exceed the maximum subsidy and the owner's matching share must be paid entirely by the owner.

The terms of each loan agreement require that rehabilitated units be used primarily for residential purposes and maintained in accordance with local codes. Each loan is interest-free, unless an owner violates the loan agreement terms.

The Grantee has funded this program with CDBG, HOME and funds previously authorized under Section 17 of the United States Housing Act of 1937. Units rehabilitated with HOME funds must be rented at affordable rates to low- and very-low-income persons for specified periods, ranging from 5 to 15 years.

Owner Occupied Program

This program provides grants to eligible homeowners to correct serious housing code violations. Homeowners must meet the gross annual income limits to be eligible for outright grants, which have a cost limitation of \$17,000 for the needed repairs. Matching grants are available for households that do not meet the limitations for outright grants. These grants require the homeowner to match each dollar contributed by the Grantee toward the identified needed repairs. The Grantee has funded this program mainly through the CDBG program, supplemented with some HOME funding.

Additional Rehabilitation Programs

These programs include the Acquisition, Rehabilitation and Resale Program, which provides affordable housing by obtaining, rehabilitating and selling unoccupied houses, and the Home Modification Program (Handicap Program) which is designed to remove architectural barriers and

provide ramps, transfers, showers, etc. The Grantee has funded these programs with CDBG and HOME funds.

Audit Objectives

The overall objective of the audit was to determine whether the Grantee administered its HUD-funded residential rehabilitation programs economically, effectively and in compliance with the regulations and requirements pertaining to the Rental Rehabilitation, HOME and CDBG programs, and with the terms and conditions of the HUD grant agreements.

The specific objectives were to determine whether the Grantee: (1) assured that rehabilitation work was completed in accordance with its specifications and work write-ups; (2) verified that rehabilitated properties met Section 8 Housing Quality Standards and/or local building codes; (3) obtained the documentation necessary to assure that rehabilitation costs were fully supported and reasonable; (4) complied with applicable procurement requirements for purchasing supplies and services; (5) ensured that rehabilitated rental properties were rented to low-and moderate-income persons at affordable rents; (6) determined that homeowners who received rehabilitation assistance were eligible; and (7) properly credited program income to the applicable HUD program.

Audit Methodology

We selected 39, or 30 percent, of the 127 properties rehabilitated under the various programs during the period February 1992 through January 1995. The sample consisted of 23 Rental Rehabilitation, 14 Owner Occupied and two Additional Rehabilitation program properties. We started with a small systematic sample of properties completed during the audit period, and on the basis of the results of this sample, we selected additional properties based on property owners/contractors identified in the initial sample whose properties had a large number of deficiencies.

For all properties selected, we reviewed the case files and inspected each property to determine whether all repair work was satisfactorily completed and the properties complied with HQS and/or local codes. Where possible, we photographed repair work that was not performed or not performed satisfactorily, and HQS violations. For Rental

Rehabilitation program properties, we also reviewed occupancy records and interviewed tenants to determine whether rent limitations and income eligibility requirements were met. We also reviewed other pertinent Grantee records and interviewed Grantee staff.

Audit Scope

Audit work was performed between February 1995 and November 1995, and covered the period February 1, 1992 through January 31, 1995. When appropriate, the review was extended to include other periods.

We conducted the audit in accordance with generally accepted government auditing standards.

The Grantee Did Not Ensure That Contractors Completed Rehabilitation Work in Accordance With Specifications

The Grantee did not ensure that contractors completed all work as specified on work write-ups for the Rental Rehabilitation, Owner Occupied and Additional Rehabilitation Programs, due to weaknesses in the systems for performing inspections before and after rehabilitation, and in supervising the performance of the inspectors. In a sample of 39 properties that we inspected, representing 30 percent of 127 repaired properties, contractors did not perform 692 specified work items and did not complete 211 other work items in an acceptable workmanlike manner. The estimated cost for the work not done or done poorly for these 903 work items is \$138,347.

In addition, substandard housing conditions were not always corrected or, in some cases, worsened because work was either not done or done poorly. As a result, the Grantee did not effectively meet its program objective of improving housing conditions for low-and moderate-income families.

Repair work must be completed in an acceptable manner

24 CFR 85.36 (b)(2) requires grantees and subgrantees to maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders. The Grantee's "Program Guidelines and Eligibility Criteria, Housing Rehabilitation Programs" handbook provides specific procedures for carrying out initial inspections to complete work write-ups and subsequent quality control inspections to assure work is completed in an acceptable manner. Work write-ups for each property provide specific details and instructions on the work to be done. The Grantee's "Performance Manual, Contractor Guidelines, Contractor Application" provides general specifications and guidance to participating contractors.

Rehabilitated properties must meet HQS and/or local codes

24 CFR 882.109 provides guidance on HUD's Housing Quality Standards (HQS), which are the minimum acceptable conditions necessary for the health and safety of assisted housing residents. Each housing unit rehabilitated with funds from HUD's Rental Rehabilitation Program and HOME Investment Partnerships Program is required to

Finding 1

meet these standards upon completion. In addition, it is the Grantee's policy that, upon completion of rehabilitation, all units must meet HQS and that rental units must meet local housing codes.

OIG inspected properties

We inspected 39 properties completed during the period November 1991 to July 1995, including properties rehabilitated under the Grantee's Rental Rehabilitation, Owner Occupied and Additional Rehabilitation Programs, as follows:

<u>Program</u>	<u>Number of Properties</u>	<u>Number of Units</u>
Rental Rehabilitation	23	34
Owner Occupied	14	14
Additional		

The Grantee's Additional Rehabilitation Programs include, among others, the Home Modification Program (Handicap Program) and the Acquisition Rehabilitation Resale Program.

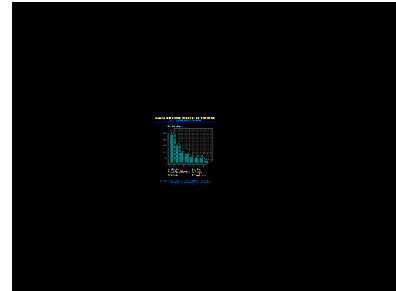
Deficiencies were noted

Of the 3,574 separate work items in the work write-ups for these 39 properties, there were 903 work items that were not completed, or were not completed in an acceptable workmanlike manner in 38 of the 39 properties, as follows:

<u>Program</u>	<u>Number of Items Not Completed</u>	<u>Number of Items Not Acceptably Completed</u>
Rental Rehabilitation	613	141
Owner Occupied	75	69
Additional	<u>4</u>	<u>1</u>

37 properties had multiple deficiencies

The work write-up for the one property where there were no deficiencies, which had been modified under the Home Modification Program (Handicap Program), had just two work items. On the other hand, 37 of the other 38 properties had multiple work items not completed or not



acceptably completed, and only six of these properties had fewer than eight deficient items. In one property, rehabilitated under the Rental Rehabilitation Program in 1993, 54 items were not completed and six items were not acceptably completed, with the 60 items representing 41 percent of the 146 separate work items for this property. Properties rehabilitated under the Rental Rehabilitation and Owner Occupied Programs had an average of 33 and 10 deficient work items, respectively.

Cost of repair work was estimated

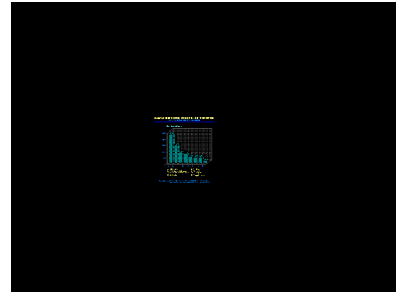
The estimated costs of work items not completed or not completed in an acceptable workmanlike manner totaled \$138,347, including \$110,401 for the Rental Rehabilitation Program, \$26,981 for the Owner Occupied Program and \$965 for a property rehabilitated under the Acquisition Rehabilitation Resale component of the Grantee's Additional Rehabilitation Programs. Because a work item could involve a number of individual steps and the use of several different materials, our cost estimates are based on a portion of the contract amount when only part of an item was not completed or not acceptably completed. When entire work items were not completed or not acceptably completed, our estimates are based on the total contract amounts. Details on the number and estimated costs of work items not completed or not acceptably completed, along with selected photographs, are presented on Appendices B and C, respectively.

Repair work not completed

-

Examples of work not completed are as follows:

Contractor installed old ductless range hoods that contained extensive rust and grease, instead of the new hoods required by the work write-up. In one case, the contractor installed an old 24-inch range hood, although the work write-up called for a new ductless 30-inch hood. The old hood was designed to be vented to the exterior, even though there were no ducts to the exterior. As a consequence, it was virtually useless for either absorbing or venting smoke and odors from the stove.



- Windows were not repaired as required by the work write-up and specifications at one property. Sash rails did not meet for weather tightness and locking. Pull chains were missing, so that sashes would not stay in place. Locks were broken. These are also serious HQS violations, since occupants do not have adequate security or protection from the elements. At other properties deteriorated wood windows were simply not replaced with new double hung or sliding vent windows, as called for in the work write-ups.
- A new hot water heater in one unit was not installed and placed on solid four-inch concrete blocks, as required by the specifications. The water heater in the unit was placed on the floor, and rust marks near the bottom of the appliance indicated that it was not new. At other properties new heaters and water heaters were installed, but were not placed on the four-inch concrete blocks.

- Instead of wooden hand railings for stairways, two-by-four-inch lumber was installed. "Two by fours" cannot be gripped as easily as standard railings, especially by small children. They also have sharp edges and can splinter easily. This is also an HQS violation.
- Single bulb wall-hung light fixtures were installed in several units instead of the ceiling-hung fixtures called for in the work write-up.
- Ceiling repairs were not made after installation of duct work, which left rooms with new duct work in an unsightly condition.
- A hallway wall was not finished and painted two coats after an old door opening was enclosed in one property. In another, the wall was not repaired around a new electrical outlet, which was not grounded and, therefore, an HQS violation.
- New plywood sheathing was not installed to the main roof as required by the work write-up.
- New plywood mounting board was not installed to support a new fuse box.
- Flue liner was not installed level with the concrete floor, and a cover was not installed for the sump pump pit.
- Basement walls were not completely refinished, as required by work write-ups.
- An old boiler was not removed after a new one was installed, and in another property an old oil tank was not replaced, as required by the work write-ups.
- New counter top ends were not finished with the same laminate as the top, and the counter top was not sealed along the wall, which is also an HQS violation.
- Subfloor was not installed in accordance with specifications and the carpet does not appear to be FHA-approved. The file did not contain any statement or

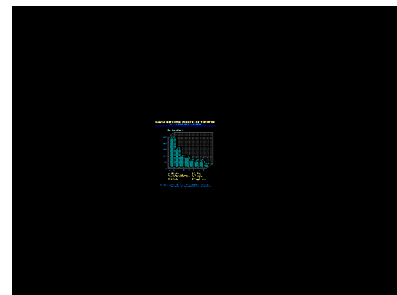
indication from the supplier that it was FHA-approved, as required by the work write-up.

Repairs were completed in an unacceptable manner

Repair work was classified as unacceptable workmanship where the contractor performed some work but used sloppy or inappropriate installation techniques, or shoddy materials.

Examples of unacceptable workmanship are as follows:

- Woodwork in a bedroom was not adequately painted, leaving chipping and peeling paint on the woodwork, which is an HQS violation.
- Discharge lines from hot water heaters were not properly installed. The discharge line should extend to approximately six inches from the floor, to prevent injury should the water heater discharge. This is an HQS violation.
- Electric outlets and switches installed in a kitchen were not flush with the wall and the openings were not sealed, or were too close to the sink. These are HQS violations.
- New exterior wrought iron handrail was not installed. Instead, the old railing was installed, with the rusting areas partially covered with paint.
- Basement steps were not installed flush with the risers, and the new wood was not painted two coats.



- Front concrete sidewalk was not properly repaired and was left dangerously sloped.
- Exterior door did not meet specifications, the dead bolt was not in line, and the door did not receive two coats of paint.
- New exterior steps made from pressure treated wood, including a landing from the back door, were not installed. Instead, one new wooden step was installed.

Properties had HQS violations after rehabilitation

HQS violations which we identified related to conditions existing before the rehabilitation occurred but not corrected, or to conditions caused by the contractor's poor workmanship. We observed a total of 243 separate HQS violations at 33 of the 39 properties inspected, as follows:

<u>Program</u>	<u>Number of Properties</u>	<u>Number of HQS Violations</u>
Rental	23	207
Rehabilitation	<u>10</u>	<u>36</u>

HQS violations

The following are examples of the conditions we observed:

- Electrical wiring to the basement, to exterior outlets and to the kitchen garbage disposal were exposed. Wiring in such areas should be placed in protective conduits to prevent severing, which could lead to injuries and/or fires. In another unit, a bedroom outlet was placed at the end of the room near an existing outlet. Although HQS requires only two electrical outlets per bedroom, this installation will result in the resident using hazardous extension cords in order to operate lamps or appliances on the other side of the room.
- Exhaust fan in bathroom was not vented to the exterior. HQS require either an operable window or an exhaust fan for venting to the exterior.

- Hand railings to the third floor and to the basement were missing.
- Electrical switch box, junction box and cover plate were missing.
- Large hole in the kitchen ceiling was not required to be repaired and painted.
- Ceiling fixture and switch in a bedroom were not replaced. The owner told us that they have been inoperable for years.
- First floor windows do not have locking hardware, which left the residents without adequate security.
- Exterior steps are a safety hazard because the top step is 10 inches below the door threshold. HQS and Montgomery County guidelines require that no step be more than eight inches high.
- Chipping and peeling paint on exterior wood surfaces was required to be removed. Paint on old structures is probably lead-based. Also, peeling paint on a bedroom ceiling was not repaired after a roof leak was fixed.
- Water heater flue vent did not have an adequate up-flow for exhaust gases to be vented to the exterior.

Systemic weaknesses caused deficient repair work

Grantee staff did not ensure that all work items were completed in a workmanlike manner and that HQS violations were identified and corrected because of:

- Weaknesses in the system for supervising the work site performance of both the rehabilitation and the quality control specialists. The former is responsible for identifying substandard housing conditions and for preparing work write-ups in order to correct each deficiency, and the latter is responsible for ensuring that each work item is completed in an acceptable manner. The Director told us that follow-up inspections were performed on a "spot" basis in order to verify that the quality control specialist had performed adequately.

However, these follow-up inspections were apparently not performed on a routine basis and have not been performed at all in several years.

- weaknesses in procedures for performing HQS inspections before and after rehabilitation. Although the rehabilitation specialists are responsible for carrying out these inspections, they do not formally document each HQS and/ or code violation on a room by room, system by system (i.e. roofing, plumbing, electrical, heating and hot water systems) basis through the use of a check-list. This increases the likelihood that some violations will not be identified.
- weaknesses inherent in the Rental Rehabilitation program, which relied largely on "owner contractors" who performed contract work on their own properties. Profit incentives for these participants came from their roles both as contractors and as owners of rental properties. As contractors, the less they spent on materials and labor the higher the profit. Property owners who are not also the contractors have no such incentive.

The large number of work items not done or not done in an acceptable workmanlike manner, and the extent of such items in nearly every property inspected, as well as the number and extent of HQS violations, indicate widespread problems in the Grantee's residential rehabilitation programs. As a result, it appears that these programs have not been very effective in improving the housing conditions of the low-and moderate-income residents they are intended to serve.

Auditee Comments

The Grantee acknowledged the deficiencies and assured that they will take all steps necessary to correct the problems.

Recommendations

We recommend you direct the Grantee to:

- 1A. Require the contractors to reimburse the HUD-funded programs for the work not completed or not acceptably completed.
- 1B. Reinspect all other properties in which rehabilitation was completed during the period January 1992 to the present and require contractors to reimburse the program for work items not completed or not acceptably completed.
- 1C. Implement a system for performing and documenting supervisory inspections on a routine basis to follow up on the work of both rehabilitation and quality control specialists. The supervisors performing these follow-up inspections should, if practicable, be rotated on a regular basis in order to increase the likelihood that more than one supervisor visits each property and reviews the performance of the rehabilitation and quality control specialists.
- 1D. Develop a plan to assure that the HQS deficiencies noted during our property inspections are corrected.
- 1E. Improve the system for performing HQS/housing code inspections by documenting these inspections on a room by room, system by system basis. After the initial inspection is performed a work write-up should be prepared to address each identified violation.

The Grantee's Procedures Were Inadequate to Prevent Conflicts of Interest

The Grantee's procedures were not adequate to prevent apparent conflicts of interest involving Grantee and subgrantee personnel, because of oversights and a lack of understanding as to the transactions and conditions that constitute conflicts of interest. It is also evident that certain Grantee employees disregarded requirements governing conflicts of interest. Diminished public confidence in the objectivity of Grantee and subgrantee staff responsible for administering HUD funds can result when previously undisclosed conflicts become known.

Conflicts of Interest

The following are apparent conflicts of interest which we observed during our review:

- The Director of the Department of Housing Services hired two contractors, who actively participate in the housing rehabilitation program either as general contractors or subcontractors, to perform work on properties that he owns, including his personal residence.

One of the contractors told us that he performed repairs on a number of properties owned by the Director, including his personal residence. We identified at least 15 transactions, totaling over \$40,000, between this contractor and the Director occurring over the six-year period from 1989 through 1995. Information subsequently provided claimed that the contractors were hired at arms-length, based on the quality of their work, and were paid the full price.

- A relative of the Director of the Department of Housing Services received a contract for roofing work in 1991. Information subsequently provided claimed that the individual was a distant relative. However, in our opinion, any family relationship creates the appearance of a conflict of interest.

- A Housing Services Department rehabilitation specialist who is involved with the administration of contracts supported by HUD funds had a contractor perform repairs on two properties that the employee owns in Norristown. The contractor was an active participant in the Grantee's residential rehabilitation programs.
- A Quality Control Inspector involved in the administration of contracts supported by HUD funds had a contractor perform repairs on his residence. The contractor, who was an active participant in the Grantee's residential rehabilitation programs, told us that he provided this work at a discount.
- A board member of the Willow Grove Development Corporation (WGDC), a non-profit subgrantee, was one of four partners who sold seven town houses to the subgrantee for \$420,000. The properties were to be rented to low-and moderate-income families. This transaction was partially funded with \$100,000 in CDBG funds and \$150,000 in HOME funds. Another board member's firm received a \$25,000 broker's commission in connection with the subgrantee's purchase of the town houses.
- Another WGDC board member's firm received a \$2,750 real estate broker's commission in connection with the subgrantee's purchase of a property using \$50,000 in CDBG funds. This property was also purchased in order to be rented to a low-or moderate-income family.
- An officer of Community Housing Services (CHS), a non-profit organization, rented a house from a for-profit developer. CHS and the housing developer participated in two projects that were partially supported with HUD funds. In one project they were partners in a 24-unit rental property which received a \$65,000 low interest deferred payment loan. In the other project, CHS received \$60,700 in CDBG funds to support the purchase of a six-unit property in Norristown built by the housing developer.

- A relative of an officer of Habitat for Humanity, a subgrantee non-profit organization, purchased a home in Norristown from the Department of Housing Services that had been rehabilitated under the Department's Acquisition/Rehabilitation/Resale program. Because the properties in this program are sold at less than the cost of acquisition and rehabilitation, the purchaser received a financial benefit. In addition, for only this purchase the Grantee paid the purchaser's share of the transfer tax as well as all closing costs, totaling \$3,696.

Conflicts Prohibited
CDBG Program

24 CFR 570.611(b), Conflicts Prohibited, provides that "except for the use of CDBG funds to pay salaries and other related administrative or personnel costs, the general rule is that no persons described in paragraph (c) of this section who exercise or have exercised any functions or responsibilities with respect to CDBG activities assisted under this part, or who are in a position to participate in a decision making process or to gain inside information with regard to such activities, may obtain a financial interest or benefit from a CDBG assisted activity or with respect to the proceeds of the CDBG assisted activity, either for themselves or those with whom they have family or business ties, during their tenure or for one year thereafter."

Paragraph (c) Persons Covered, provides that "the conflict of interest provisions of paragraph (b) of this section apply to any person who is an "employee, agent, consultant, officer, or elected official or appointed official of the recipient, or of any designated public agencies, or subrecipients which are receiving public funds under this part."

Paragraph (d) provides that HUD can grant exceptions provided there is a public disclosure of the nature of the conflict and an opinion from the recipient's attorney that no state or local law would be violated if HUD granted the exception.

Conflicts Prohibited -
HOME and RRP

24 CFR 92.356 and 511.12 provide the same prohibitions and exceptions for activities financed through the Home Investment Partnerships (HOME) and Rental Rehabilitation Programs. These provisions apply in all cases not governed by 24 CFR 85.36, including the acquisition and disposition of real property.

Standards of Conduct
Required

24 CFR 85.36 (b)(3) which applies to all three programs provides that " grantees and subgrantees will maintain a written code of standards of conduct governing the performance of their employees engaged in the award and administration of contracts. No employee, officer or agent of the grantee or subgrantee shall participate in the selection, or in the award or administration of a contract supported by Federal funds if a conflict of interest, real or apparent, would be involved".

Conflicts Prohibited -
State Law

The Commonwealth of Pennsylvania ethics requirements for public officials and employees are set forth in Act 9, passed in 1989. Specifically, Chapter 15, paragraph 403(a) prohibits public officials and employees from engaging in conduct that constitutes conflict of interest.

Conflicts Prohibited -
Grantee Requirements

The Grantee also has its own requirements regarding conflicts of interest in Section 6 of its Employee Handbook, which is provided to each employee in the Housing Services Department. The Grantee also provides a "Handbook for CDBG Subrecipients on Administrative Systems" to each subgrantee. This handbook describes in detail HUD requirements pertaining to conflicts of interest. In addition, the Grantee provides technical assistance to its subgrantees on all applicable HUD requirements.

Waivers Not Requested

There was no evidence that the Grantee requested that HUD grant exceptions for any of these transactions. Apparently, the officers of the non-profit organizations were not aware that they were involved in conflicts of interest that must be disclosed. However, supervisors and employees of the Housing Services Department should have known that ongoing business relationships with contractors who participate in the Department's rehabilitation programs constitute conflicts of interest. In this regard, Grantee staff informed us that the WGDC and CHS were contacted regarding the conflicts cited by our audit.

The Grantee should provide subgrantee personnel with a better understanding of conflicts of interest and encourage public disclosure, where necessary, in order to help prevent undisclosed conflicts from occurring. The Grantee should also take appropriate action to deter its own employees from engaging in business transactions that could result in conflicts of interest.

Auditee Comments

The Grantee acknowledged the deficiencies and assured us that they will take all steps necessary to correct the problems.

Recommendations

We recommend that you direct the Grantee to:

- 2A. Submit a detailed plan of action to ensure that Grantee officials and employees comply with all the required Federal, State and local prohibition against engaging in activities which result in conflicts of interest. This plan should include the types of conflicts detailed in this finding.

- 2B. Implement additional procedures to detect conflicts of interest in subgrantee organizations, including review of documents submitted by subgrantees to determine if conflicts of interest exist; and, appropriate follow-up action, such as disapproval of proposed transactions that involve a conflict of interest, or request that HUD grant an exception.

- 2C. Strengthen procedures to train Grantee and subgrantee staff to identify and disclose or, when appropriate, avoid activities that involve conflicts of interest.

The Grantee Did Not Ensure That Rental Rehabilitation Costs Were Fully Supported and Reasonable

The Grantee did not obtain required cost documentation from rental property owners who performed rehabilitation work on their own properties. Instead, the Grantee reimbursed the owners based on cost estimates which, in many instances, were inflated. This reimbursement method was apparently caused by a misunderstanding between a Grantee employee and a staff member in HUD's Pennsylvania State Office who provided guidance by telephone. As a consequence, the Grantee could not ensure the reasonableness of costs and may have misspent a substantial amount of HUD funds in its Rental Rehabilitation program due to inflated estimates.

Programs should be charged for actual costs

24 CFR 85.20(b), which is applicable to the CDBG, HOME and Rental Rehabilitation programs, requires grantees to follow applicable OMB cost principles and to maintain accounting records supported by source documentation, including paid bills. OMB Circular A-87, Cost Principles for state and local governments, provides in Attachment A for charging Federal programs on the basis of costs incurred.

Owners can perform repair work on their properties

24 CFR 511.10 (f) (4) provides specific guidance to Grantees who permit participating owners to perform part or all of the work on their properties under the HUD Rental Rehabilitation Program. It states that if the owner is not a practicing, licensed contractor eligible rehabilitation costs are limited to the costs of materials purchased by the owner and used on the project, and the cost of other eligible work performed by practicing, licensed contractors, subcontractors or tradesmen on the project. When owners are licensed, practicing contractors eligible costs can also include the contractor's paid labor, overhead and profit, similar to what these items would be on a project not owned by the contractor.

Invoices for actual costs must be submitted

HUD policy regarding such owner/contractors had been set forth in October 1988 in Notice CPD-88-37, Rental Rehabilitation Program Policy for Assisting "Self Help" Projects. Paragraph 4 of this Notice also provided that the grantee must establish and implement adequate procedures to ensure that owner/contractors submit proper documentation for rehabilitation costs. It also provided that invoices submitted in such cases must be from actual materials suppliers and/or contractors/subcontractors, and not merely an invoice from the owner to the grantee.

Cost estimates were used for reimbursing owner/contractors

Nineteen of the 23 rental rehabilitation properties reviewed were rehabilitated by owner/contractors. In all 19 cases the Grantee used either an "in-house" cost estimate prepared by its rehabilitation specialist as a basis for reimbursement or the owner/contractor's bid if it was within 15 percent of the estimate, instead of actual, documented costs. The Grantee did not obtain any source documentation such as invoices, subcontracts, etc. from these owner/contractors, with one exception.

According to the Grantee's rehabilitation specialist who worked on the rental program, several years ago, he attempted to obtain source documentation, including invoices, from one owner/contractor who was very active in the program. The documentation that was provided, however, was voluminous, unorganized and difficult to relate to a specific property. He also said that in response to his inquiry, a HUD staff member told him via telephone that it was not necessary to obtain source documentation from owner/contractors. However, he did not ask for or receive this guidance in writing. Subsequently, the Grantee did not request owner/contractors to provide source documentation to support costs, but relied solely on cost estimates as a basis for reimbursement.

Cost estimates were inflated and based on estimating manuals

The Grantee reimbursed owner/contractors for rehabilitation work performed on the basis of inflated cost estimates. Because cost estimates for the Rental Rehabilitation program were developed using commercially available cost estimating manuals (published annually) the estimated costs for materials were generally well in excess of prices charged by local retailers. In addition, the estimates

included a large, poorly supported allowance for overhead and profit. As a result, a substantial portion of HUD funds used for housing rehabilitation were misspent.

The Grantee reimbursed owners who performed their own work for the cost of materials, overhead and profit in accordance with 24 CFR 511.10 (f)(4), as if they were practicing, licensed contractors. In some cases, owner/contractors were also reimbursed for labor costs. The Grantee continued this practice for all rental rehabilitation projects, including those funded through the CDBG and HOME programs.

Staff did not attempt to determine current market prices

The Grantee's rehabilitation specialist who worked on the Rental Rehabilitation program relied on two commercially-available estimating manuals which are published annually, in order to develop "in-house" cost estimates. The Grantee reimbursed the amount an owner/contractor bid for a particular project, providing it was within 15 percent of the estimate. If the bid was not within this range, the Grantee made the reimbursements based on the estimate. The rehabilitation specialist did not attempt to determine the current market prices of commonly-used materials in order to establish a basis for estimating costs, nor did the Grantee solicit bids from other contractors when owner/contractors were involved.

Analysis and review of cost estimates developed during the audit period disclosed the following:

Estimated costs exceeded retail prices

- The estimated cost for commonly-used materials substantially exceeded current retail prices charged for these items. Specifically, our comparison of material costs shown on "in-house" estimates prepared during the audit period for 15 commonly-used items, including drywall, range hoods, water heaters, etc., with current prices charged by local retailers (Appendix D) indicated that the local prices were generally lower. Of the 15 items compared, the local price of only one, drywall, was currently higher than the Grantee's estimate.

For purposes of comparison the prices charged by local retailers were adjusted by the same percentage (50 percent) provided in the estimating manual most often used by the Grantee's rehabilitation specialist.

Overhead and profit based on manual

- The Grantee gave owner/contractors a 50 percent allowance for overhead and profit, as recommended in one of its cost estimating manuals, although it had no evidence that these participants received such a percentage on rehabilitation work on properties they did not own.

Evidence needed that owners were licensed, practicing contractors

- The Grantee did not have evidence that every owner/contractor who was reimbursed for overhead and profit was actually a licensed, practicing contractor, as required. Of the 23 rental rehabilitation properties which we sampled, 19 were completed by five different owner/contractors. There was some evidence that two were actually licensed, practicing contractors, because they had participated in the Owner Occupied program, and one owner/contractor claimed to be licensed and presented a list of other contracts completed. However, the Grantee had very little evidence that the two others, including one owner who had completed 12 of the 23 properties in our sample, were licensed, practicing contractors.

As a consequence, Rental Rehabilitation program costs were higher than necessary because the Grantee's estimating methods resulted in materials costs that were higher than prices charged by local suppliers for similar items and the estimates included questionable and unsupported mark-ups. In addition, some of the participating owner/contractors may have been ineligible for these mark-ups.

Grantee staff attempted to justify noncompliance

During the audit, the Grantee's Director told us that:

- The Grantee should not be held responsible if HUD provides incorrect guidance.
- One of the most active owner/contractors usually performed many more repair items than are shown on the work write-ups, in order to bring properties up to Housing Quality Standards. These additional items were not reimbursed. Therefore, at least in regard to these properties, the program achieved its purpose and received value for the funds expended, even if some items were overestimated.

- Comparison of the Grantee's cost estimates to prices charged by local building supply stores affiliated with national chains is questionable, because contractors in the program do not make purchases at such stores.

OIG opinion that noncompliances are not justified

While we cannot be certain as to the guidance provided by HUD staff over the telephone in this matter, HUD usually issues all policy changes in writing. In this regard, the guidance that was supposedly given represented a significant change in policy.

Although one or more owners may have made more repairs than are shown on the work write-ups, the Grantee cannot document the specific items that were done, or the cost or necessity of this other work.

With regard to the building supply stores used by owner/contractors, our review of copies of invoices from the one instance in which an owner/contractor provided them to the Grantee noted that they included some from a nationally-affiliated chain. On the other hand, if an owner/contractor prefers particular suppliers, we do not believe the HUD-funded program should pay the additional costs when these suppliers charge significantly higher prices.

Auditee Comments

The Grantee acknowledged the deficiencies and assured us that they will take all steps necessary to correct the problems.

Recommendations

We recommend that you require the Grantee to:

- 3A. Obtain supporting documentation for the costs of materials, labor, and subcontracts incurred by owners who perform their own work under the Rental Rehabilitation program.
- 3B. Reimburse contractors who perform work on their own properties only for actual material and paid labor costs, and for overhead and profit similar to

what these costs would be for properties not owned by such contractors.

- 3C. Develop material cost estimates on the basis of actual prices charged by local vendors supplemented, where necessary, by cost estimating manuals. Estimates of installation costs should likewise be developed on the basis of amounts charged by arms-length contractors for similar work items.

The Grantee Needs to Improve Procedures for Purchasing Supplies and Services

The Grantee did not always obtain price quotations from an adequate number of sources, publicly advertise invitations for sealed bids or buy from the lowest-priced vendor, as required when purchasing construction supplies and services for use in its Owner Occupied rehabilitation program. In addition, the Grantee paid contractors for certain services even though the contractors had actually provided price quotes for other services. Because the Grantee had no written procurement procedures and staff responsible for purchasing these supplies and services were not familiar with HUD procurement requirements, there was no assurance that the lowest price was obtained for over \$234,000 in supplies and services purchased during the audit period.

Grantee must comply with Federal and State procurement requirements

24 CFR 85.36(b) provides that Grantees will use their own procurement procedures which reflect applicable State and local laws and regulations and will maintain records sufficient to detail the significant history of a procurement. Paragraph (c)(3) provides that Grantees must have written selection procedures. Paragraph (d)(1) provides that, "small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000 in the aggregate. If small purchase procedures are used, price or rate quotations will be obtained from an adequate number of qualified sources." The Commonwealth of Pennsylvania, however, requires publicly advertised solicitations and sealed bids for purchases of supplies or equipment costing over \$10,000.

Grantee did not comply with requirements

The Grantee did not follow applicable requirements when purchasing construction supplies and services for properties undergoing rehabilitation under its Owner Occupied and Acquisition/ Rehabilitation/Resale programs. Items purchased included heating systems, kitchen cabinets and appliances, storm doors, windows and certain inspection services.

In the five-year period ended September 30, 1995, the Grantee:

- obtained price quotations from only one source for 14, or approximately 40 percent, of 35 small purchase contracts awarded.
- purchased construction items costing more than \$10,000 in the aggregate without obtaining competitive sealed bids in response to public advertisements.
- made awards to other than the lowest bidder for nine, or approximately 25 percent, of the 35 contracts awarded. There was no justification documented in the Grantee's files for these actions.
- awarded supply contracts to the lowest bidder, but then made purchases from other vendors in at least three instances. Again, there were no written justifications for these actions.
- continued purchasing supplies and services from vendors after the expiration of contract periods, without soliciting new price quotes.
- awarded contracts for certain inspection services to low bidding vendors, but then also purchased other, more expensive services from these same vendors without soliciting any price quotes. For example, the vendor who submitted the lowest bid and was awarded a contract for wood-destroying insect inspections was also paid for treatment services when the inspection results indicated an insect infestation. However, the Grantee had not solicited price quotes for treatment services from this vendor or any others. The vendor was paid \$32,693 for inspection and treatment services in this manner.

We noted the Grantee also obtained chimney cleaning and insulation installation services on a non-competitive basis in a similar manner after awarding contracts for chimney and insulation inspection services.

Grantee staff gave reasons for noncompliance

The rehabilitation specialist who was responsible for ordering supplies and services for the Owner Occupied and Acquisition/ Rehabilitation/Resale programs told us that he tried to obtain the most reasonable prices for the Grantee,

but he did not use written procedures and was not familiar with HUD requirements pertaining to procurement. He also said that the Grantee has discontinued direct buying of construction supplies and services except for wood-destroying insect inspections. Additional comments from Grantee staff offered detailed explanations for the individual situations cited above, which, in our opinion, do not obviate the violations of the procurement requirements.

The Grantee did not obtain price quotes from an adequate number of sources and, in some instances, did not obtain any price quotes before buying supplies and services. As a consequence, it not could assure that it had obtained the most reasonable prices. We noted, for example, that the price of oil-fired boilers increased twice when the Grantee obtained price quotes from only one source. Subsequently, the price decreased by nearly eight percent when the Grantee solicited quotes from two suppliers.

Auditee Comments

The Grantee acknowledged the deficiencies and assured us that they will take all steps necessary to correct the problems.

Recommendation

We recommend you direct the Grantee to:

- 4A. Develop written procurement procedures for its HUD-funded rehabilitation activities which include: solicitation of price quotes from an adequate number of sources when carrying out small purchase transactions; advertisement of solicitations and sealed bids when purchasing supplies costing over \$10,000; and, maintenance of records sufficient to detail the significant history of a procurement, including rationale for contractor selection or rejection.

Improvements Are Needed to Ensure Rental Rehabilitation Benefits Low-to Moderate-Income Households

The Grantee is not ensuring that low-and moderate-income persons are benefiting from the Rental Rehabilitation program, as required. Because the Grantee did not obtain the necessary documentation from property owners to verify that rents were affordable and tenants were qualified, there was no assurance that rehabilitated rental units benefited low-to moderate-income households. In addition, we noted that four tenants who paid their own utilities were overcharged for their monthly rent, based on the utility allowance for the Section 8 program.

Rehabilitated units must remain affordable

24 CFR 92.252(a)(5) provides that units rehabilitated with HOME funds must remain affordable for a minimum specified period, which varies between 5 and 15 years, based on the amount spent per unit. Paragraph (b) provides that participating jurisdictions must review and approve rents and monthly allowances for tenant-paid utilities and services proposed by owners. The maximum monthly rent must be recalculated by the owner and reviewed and approved by the participating jurisdiction annually.

Occupancy by low-to moderate-income households at affordable rents is required

24 CFR 570.208 (a)(3) provides that an eligible CDBG housing activity carried out for the purpose of providing or improving permanent residential structures, upon completion, will be occupied by low-and moderate-income households. For rental housing, occupancy by low-and moderate-income households must be at affordable rents to qualify under this criterion. The recipient must adopt and make public its standards for determining affordable rents for this purpose.

24 CFR 511.10 (a)(4) provides that benefit for lower income families under the Section 17 Rental Rehabilitation program will be considered to occur only where dwelling units in projects rehabilitated with rental rehabilitation grants are initially occupied by such families after rehabilitation.

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Grantee must obtain tenant profiles, income verifications and leases

The Grantee has attempted to comply with these requirements by including, in a package sent to each owner who applies for the Rental Rehabilitation program, a schedule showing maximum rents per unit. In addition, the Grantee requires owners to send in with each application for occupied units (1) tenant profiles which show occupants' names, incomes, monthly rents and monthly utility payments; (2) income verifications; and, (3) lease copies in order to verify rents. For units that are vacant at the time applications are submitted, owners must provide this documentation as soon as each unit is occupied. The Grantee requires owners to submit income verifications and lease copies annually for the duration of each loan agreement. For units rehabilitated with CDBG funds, the Grantee adopted rent limits based on 65 percent of the area median income, as defined by HUD as the affordable rent standard in response to 24 CFR 570.208 (a)(3).

Occupancy Upon Completion

The Grantee did not always obtain tenant profiles, income verifications and lease copies before rehabilitation or after initial occupancy. Some tenant profiles that were sent in were not fully completed. Others were sent in late. The following shows the results of a sample of occupancy information obtained by the Grantee for 31 units rehabilitated during the audit period.

<u>Program</u>	<u>Total No. of Tenants</u>	<u>Income Not Verified</u>	<u>Lease Not Obtained</u>	<u>No Tenant Profiles Received</u>	<u>Income Amounts Not Given on Tenant Profiles</u>
HOME	9	4	4	0	0
CDBG	14	11	8	3	2
SECT 17	<u>8</u>	<u>8</u>	<u>8</u>	<u>0</u>	<u>2</u>

Utility Allowances

Owners did not always complete tenant profile information pertaining to monthly payments for utilities and services. As a consequence, the Grantee could not verify that owners adhered to rent limitations when tenants paid for their utilities. We noted that at least 19 tenants in our sample paid for their own utilities. For purposes of comparison we

calculated gross rents for these 19 tenants using the Montgomery County Housing Authority's schedule of utility allowances for the Section 8 program. This comparison indicated that four tenants were overcharged as follows:

Grantee staff commented that only one tenant, whose property was rehabilitated with HOME funds, was overcharged, since the other three tenants were CDBG-funded properties which do not require rent caps. However, in our opinion, the regulations provide that, upon completion, the requirement for low-and moderate-income occupancy includes consideration of tenant-paid utilities.

Occupancy After Completion

The Grantee did not obtain all tenant profiles for units in the HOME program, which are due each year after completion. For the nine HOME units in our sample, there were four already completed more than a year as of April 30, 1995. However, the Grantee had obtained no tenant profiles for any of these units as of June 2, 1995.

The Grantee's housing specialist who is responsible for obtaining tenant profiles and leases told us that some owners have been uncooperative, even though they agreed to submit the documentation under the terms of the loan agreements. She also told us there was no evidence tenant profiles were obtained before she came to work for the Grantee in 1993.

Auditee Comments

The Grantee acknowledged the deficiencies and assured us that they will take all steps necessary to correct the problems.

Recommendations

We recommend you require the Grantee to:

- 5A. Develop and implement procedures to verify tenant incomes to ensure they are low-to moderate-income persons.
- 5B. Direct owners to establish utility allowance amounts, where appropriate, and monitor the rents being charged to verify tenants are not overcharged.
- 5C. Require the owners of the three properties cited in this finding to reimburse the tenants for the overcharged rents.
- 5D. Require the uncooperative owners to repay their loans if they do not comply with the regulations.

The Grantee Needs to Improve Systems for Scheduling and Conducting Annual Inspections of Rental Units

The Grantee did not complete all annual inspections of rental units after rehabilitation, as required. Because the Grantee did not maintain and update a complete list of rental properties to be inspected; coordinate with the Montgomery County Housing Authority; or, adequately supervise the inspector responsible for carrying out the inspections, there was no assurance that rental units were maintained in a decent, safe and sanitary condition after rehabilitation.

Annual inspections of rental properties are required

24 CFR 92.504 provides that agreements must require that owners of rental housing assisted with HOME funds maintain the housing in compliance with Section 8 Housing Quality Standards (HQS) and local code requirements for the duration of the agreement. The Grantee's loan agreements require owners to maintain properties in accordance with local property codes and agree to annual inspections to be conducted by the Grantee. The Grantee included these same provisions in loan agreements for properties rehabilitated with CDBG and Rental Rehabilitation program funds.

Listing of properties was incomplete and not all properties were inspected

The Grantee's listing of units due for annual inspection was not complete. Specifically, the listing should have 157 properties. However, 24 properties were not on the listing. Also, the Grantee's inspector did not conduct inspections at all of the properties on the listing. We identified six listed properties that were not inspected, but should have been inspected at least once. We also noted that:

- There was no system for ensuring that newly-rehabilitated rental units were added to the listing during the audit period. Twelve of the 24 units that should have been on the listing were completed in 1993 and 1994. The inspector responsible for carrying out these inspections told us that he was provided a listing when

he began work in 1993, but that he has not yet added units completed in 1993 and 1994.

- The Grantee had never compiled a complete listing of units to be inspected. Twelve of the twenty four units that should have been on the listing were completed between 1985 and 1988.
- The Grantee relied on the Montgomery County Housing Authority to inspect units whose tenants received housing subsidies under the Authority's Section 8 program, but did not regularly obtain information on the results of these inspections. Therefore, if a Section 8 tenant moved or if a unit repeatedly failed to pass Section 8 HQS, the Grantee would not have the information necessary to respond appropriately. We noted at least one unit that the inspector told us was occupied by a tenant receiving a Section 8 subsidy but which, in fact, was not.

Inspection system and supervision were inadequate

The Grantee did not complete all annual inspections as required because it had no system for updating the list of properties to be inspected or obtaining information on the results of inspections carried out by Housing Authority inspectors. In addition, the inspector responsible for carrying out inspections was not adequately supervised in order to ensure that properties on the list were timely inspected. As a consequence, the Grantee's annual inspection system was not effective in ensuring that owners maintained rehabilitated properties as required.

Grantee staff informed us that attempts were made to add newly-rehabilitated units to the listing, and that the method for inspecting units would be changed.

Auditee Comments

The Grantee acknowledged the deficiencies and assured us that they will take all steps necessary to correct the problems.

Recommendations

We recommend that you direct the Grantee to:

- 6A. Develop a complete list of properties to be inspected and establish a system to update the list on a regular basis.
- 6B. Coordinate with the Housing Authority in order to obtain the results of Authority inspections of properties that are also in the Grantee's Rental Rehabilitation program.
- 6C. Establish a system to supervise the inspector responsible for annual inspections to ensure that all inspections are performed timely.

The Grantee Should Verify Contractors' Insurance Coverage

The Grantee did not obtain documentation assuring that contractors participating in the Owner Occupied rehabilitation program had liability insurance coverage, as required. This occurred because there was insufficient oversight and some confusion concerning the responsibility for obtaining and reviewing insurance certificates. As a consequence, the Grantee had no assurance, in many cases, that it was adequately protected from liability if the actions of participating contractors resulted in property damage or personal injuries.

Evidence of liability insurance is required

The Grantee's Contractor Instructions and Application requires that participating contractors provide evidence of comprehensive general and automobile liability coverage. For each job under contract, the contractor must furnish a Certificate of Insurance containing the appropriate homeowner's name and address.

Evidence of liability insurance was not obtained

During the audit period, 43 Owner Occupied program contracts were completed by 13 different contractors. However, the Grantee's files indicated that 11 of these contractors failed to provide Certificates of Insurance for periods when rehabilitation jobs were completed. Only two contractors provided Certificates covering periods when six different rehabilitation jobs were completed. Therefore 37, or 86 percent, of the Owner Occupied program rehabilitation jobs were completed without evidence that the contractors had sufficient insurance coverage. For the two Certificates of Insurance that were submitted, neither listed the homeowner's name and address, as required.

Grantee staff was confused

There was confusion among Grantee staff concerning who is responsible for collecting and checking the documents, as well as insufficient supervision. Specifically, one rehabilitation specialist told us that another staff member obtains and checks insurance documents. However, the supervisory rehabilitation specialist acknowledged that rehabilitation specialists have this responsibility. In this regard, Grantee staff provided a memorandum which was recently issued to the rehabilitation staff reminding them

Finding 7

that it is their responsibility to obtain valid contractors' insurance certificates.

Auditee Comments

The Grantee acknowledged the deficiencies and assured us that they will take all steps necessary to correct the problems.

Recommendation

We recommend that you direct the Grantee to:

- 7A. Strengthen the system for ensuring that contractors submit evidence of insurance coverage for each rehabilitation job, by reemphasizing to staff members assigned this task the necessity of verifying insurance coverage and by providing the necessary supervisory oversight.

Internal Controls

In planning and performing our audit, we considered internal control systems of the Montgomery County Department of Housing Services to determine our auditing procedures and not to provide assurance on internal control. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change and monitoring.

Control Categories

We determined that the following internal control categories were relevant to our audit objectives:

- Property Inspections
- Conflicts of Interest
- Cost Reasonableness
- Procurement
- Occupancy
- Contractor Qualifications

Scope of Work

We evaluated all of the relevant control categories identified above by determining the risk exposure and assessing control design and implementation.

Significant Weaknesses

A significant weakness exists if internal control does not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review, we believe the following items are significant weaknesses:

- Property Inspections (Findings 1 and 6)
- Conflicts of Interest (Finding 2)
- Cost Reasonableness (Finding 3)

- Procurement (Finding 4)
- Occupancy (Finding 5)
- Contractor Qualifications (Finding 7)

Follow Up On Prior Audits

This was the first OIG audit of Montgomery County's HUD-funded residential rehabilitation programs. Prior audits of Montgomery County operations performed by independent auditors contained no findings pertaining to the HUD-funded programs.

Schedule of Ineligible Costs

<u>Finding</u>	<u>Ineligible</u>
1	<u>\$138,347</u>

Ineligible amounts are not allowed by law, contract, HUD or local agency policies or regulations.

Distribution

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Associate General Counsel, Office of Assisted Housing and
Community Development, GC (Room 8162)
Assistant Director in Charge, US GAO, 820 1st ST. NE Union Plaza,
Bldg. 2, Suite 150, Washington, DC 20002
Attn: Mr. Cliff Fowler

Board of Commissioners (3)
County of Montgomery
Court House
Swede and Airy Streets
Norristown, PA 19404-0311

