

Audit Report

**Department of Development Services  
Neighborhood Stabilization Program 2  
Recovery Act Compliance Audit**

April 2011



**Audit Staff**

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## Executive Summary

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We recently concluded an audit of the Department of Development Services' (Department) Neighborhood Stabilization Program 2 (Program), which is funded by the American Recovery and Reinvestment Act of 2009 (Recovery Act). The purpose of our audit was to determine whether the Program is operating in compliance with the grant agreement and the general provisions of the Recovery Act.

In February 2010, the U.S. Department of Housing and Urban Development (HUD) awarded the City a \$22 million three-year competitive grant to stabilize neighborhoods that have suffered from foreclosure and abandonment. At the end of the Program's first year, 26 of the 100 required properties have been acquired, with an additional 62 properties currently in escrow. Additionally, more than 65% of the total amount awarded has been spent or obligated to date. The Program appears to be on track to meet the strict spending timeline and acquisition goals as set forth by HUD.

The Recovery Act places great emphasis on accountability and transparency in the use of taxpayer dollars. Awardees of Recovery Act funds must comply with applicable Federal procurement regulations, extensive reporting requirements and specific provisions such as Whistleblower Protection. Grant administration within the City is decentralized; therefore responsibility lies with the Department to ensure compliance with applicable Federal regulations.

Overall, we found the Department's procurement practice does not clearly align with Federal regulations, and certain reporting requirements specific to the Recovery Act are not being met. The Program's current procurement practice exposes the City to unnecessary risk and liability and increases the Program's susceptibility to fraud. Moreover, non-compliance with Recovery Act requirements could result in sanctions from the funding agency, up to and including refunding the grant receipts and suspension and debarment from receiving future Federal funding. It is imperative that the Department take steps to ensure the Program, as well as all other Federal funded programs, operate in compliance with applicable Federal regulations and Recovery Act requirements to prevent serious repercussions.

Our audit results and recommendations were discussed with Management during the course of the audit and some corrective action may have already been implemented. Management also represents they are currently working with the Department of Financial Management to improve the procurement practice and ensure compliance with applicable rules and regulations. As such, our Office is requesting an update in six months on the Department's efforts to address the issues noted in this audit report. We commend the Department's efforts and express our appreciation to them for providing their time, information, and cooperation during the audit.



## **Background**

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In February 2009, President Obama signed a \$787 billion stimulus package, otherwise known as the Recovery Act, into law to help stimulate the economy and create jobs. The Neighborhood Stabilization Program – 2 (NSP2) was one of the initiatives of the Recovery Act and was established to stabilize neighborhoods that have suffered from foreclosure and abandonment. In early 2010, HUD awarded \$1.93 billion in NSP2 grants nationwide.

The City of Long Beach (City) applied for and was awarded \$22 million of NSP2 competitive grant funds in February 2010. In addition to the \$22 million, the City has added another \$1.5 million in other non-Federal funds to the Program. The primary purpose of the City's Program is to promote neighborhood stabilization through increased home ownership opportunities, specifically for first-time homebuyers of low- and moderate-income. Program assistance available to qualified participants towards the purchase of eligible properties includes:

- Silent second mortgage assistance loans;
- Down payment and closing cost assistance; and
- Rehabilitation of properties for first-time homebuyers whose incomes do not exceed 120 percent of the area median income (AMI).

In addition, the grant requires 25 percent of the award be used to assist individuals whose incomes do not exceed 50 percent of AMI. To assist with meeting this requirement, the City entered into a Consortium Agreement with Habitat for Humanity (Habitat), a Los Angeles based non-profit full service housing developer, to administer this portion of the grant. Habitat acquires and rehabilitates foreclosed and abandoned homes within the City and sells them to qualified participants providing them with silent second mortgage assistance loans.

The grant agreement sets forth stringent requirements. Fifty percent of the awarded amount (\$11 million) must be spent within two years after execution of the grant (by February 2012), and the entire amount (\$22 million) must be spent within three years (by February 2013). Additionally, the City has to meet HUD's required acquisition minimum of 100 properties; however, the City has set a slightly higher goal of 111 properties.

## **Audit Objectives, Scope, and Methodology**

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The objective of our audit was to determine whether the Program is operating in compliance with the grant agreement and the general provisions of the Recovery Act. The scope of the audit was for the period February 11, 2010, through February 10, 2011.

Procedures performed include the following:

- Obtained and reviewed the Recovery Act and applicable Federal regulations;
- Obtained and reviewed the Program's Grant Agreement and Consortium Agreement;
- Interviewed Program personnel and obtained an understanding of the internal controls related to our audit objectives;
- Obtained an understanding of the process for awarding contracts and reviewed contracts, on a sample basis, for compliance with Federal procurement regulations;
- Reviewed City purchasing requirements;
- Reviewed and assessed Program activities and progress to date;
- Reviewed Program expenditures for eligibility, as well as property and participant files, on a sample basis; and
- Obtained and reviewed the Prime Recipient Report for the quarters ending September 30, 2010 and December 31, 2010.

We conducted this performance audit in accordance with Generally Accepted Government Auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **Issues and Recommendations**

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### **Issue #1 – Procurement Practice Needs To Be More Aligned With Federal Regulations**

The Code of Federal Regulations, Title 24, Section 85.36 (CFR 24.85.36), establishes uniform procurement requirements for local governments that receive Federal grants. Requirements include the following:

- Small purchases (those under \$100,000) must obtain price or rate quotes from an adequate number of qualified sources. If, after a solicitation of a number of sources, competition is determined to be inadequate, a cost analysis is required (i.e. verifying the proposed cost data);
- All procurement transactions will be conducted in a manner providing full and open competition; and
- Grantees must maintain records sufficient to detail the significant history of the procurement, including rationale for the method of procurement, contractor selection, and basis for the contract price.

In addition, the City's Purchasing Division has established procurement policies and procedures, including requiring a *minimum* of three written quotes for all purchases over



\$10,000. Since grant administration within the City is decentralized, responsibility lies with the Department to ensure the Program complies with all applicable Federal and City procurement requirements.

During our audit, we found the Department's established internal procurement policies and procedures for the Program were not clearly aligned with Federal regulations. For example, of the 11 rehabilitation contracts initiated, only one received multiple competitive bids. While the contracts were all under \$100,000 and qualified as small purchases by CFR 24.85.36, bids were not obtained by an adequate number of qualified vendors and did not meet the City requirement of three written bids.

Further, the method by which bids were solicited for rehabilitation work changed several times during our audit. None of the methods used appear to have been effective in ensuring a full and open competition. For example, a minimal number of qualified vendors were solicited resulting in an inadequate number of competitive bids received. Also, uniform job walks were not being conducted to ensure all the vendors were receiving consistent information regarding job specifications.

Moreover, we found inconsistencies between Management's procurement policies and procedures and actual practice. Although Management has the discretion to deviate from their internal policies and procedures, explanation and justification for the deviations were not documented. Written justification for Management's decisions should be maintained to ensure a fair and transparent procurement process.

Federal procurement requirements are intended to encourage fair and open competition in the contracting process that enables an evaluation of both price and quality to provide assurance that the public is receiving the best value for its money. The lack of a competitive bidding process and compliance with established procurement policies and procedures not only increases the Program's susceptibility to procurement fraud, waste, and/or abuse, but also increases the likelihood that errors and/or irregularities will go undetected.

The Department has represented they are currently working with the Purchasing Division to improve the Program's procurement practice and ensure compliance with all applicable rules and regulations. We acknowledge the unique situation surrounding this procurement process, such as the individual homeowners having control over the physical job site and the stringent spending deadlines associated with Recovery Act funding. However, this does not preclude the Department from following applicable Federal procurement regulations. Therefore, we encourage the Department to develop a procurement practice that complies with applicable Federal and City requirements.

### **Recommendations to Issue #1:**

- 1) Review current procurement practice in conjunction with applicable Federal Regulations and City policy to ensure compliance with these rules and regulations.
- 2) Ensure current procurement policies and procedures align with best practices. Examples include, but are not limited to:
  - Provide all qualified vendors an equal opportunity to bid on jobs;
  - Require a minimum of three written bids for each job;
  - Develop a selection criteria (i.e. lowest bidder) and apply consistently to all bidders; and
  - Provide same information to all vendors so no one has an advantage.
- 3) Ensure all employees affiliated with execution of the Program receive extensive training in the following areas:
  - Ensuring applicable Federal procurement regulations are included in all Federally funded contracts; and
  - Establishing and executing a competitive bidding practice that complies with Federal procurement rules.
- 4) Document justification and explanation for any departures from Departmental procurement policies and procedures.

### **Issue #2 – Lack of Compliance with Recovery Act Requirements**

The Recovery Act established new unprecedented levels of accountability and transparency in government spending that include requiring recipients to submit quarterly reports and requiring all job sites to post signage of Whistleblower protections. The Recipient Reports are posted on the Federal Recovery Act's website and include critical information such as the amount of recovery funds received and expended, the number of jobs created, and payments made to vendors.

During our audit, we found areas of non-compliance with the Recipient Report and Whistleblower provisions. Table 1 illustrates these requirements and areas of non-compliance. The reporting issues were communicated immediately to Management and as a result some items were corrected on the subsequent quarterly report as indicated below.

The Federal government places a strong emphasis on complete, accurate and timely reporting and is a term and condition of receiving Recovery Act funding. As such, non-compliance with these requirements could result in sanctions from the funding agency, including termination of funding and/or suspension and debarment from receiving future Federal funding. Therefore, it is critical that the Department comply with all Recovery Act requirements.



**Table 1**  
**Recovery Act Requirements and Areas of Non-Compliance**

**Recovery Act Requirements vs. Current Practice**

<b>Recovery Act Requirements</b>	<b>Reported Inaccuracies and Current Practice</b>
Recipient Report Requirement - Number of Jobs Created (reported in FTE's)	The Department reported zero FTE's created at September 30, 2010 although there were jobs funded by the Program. FTEs were reported at December 31, 2010.
Recipient Report Requirement - Total Number and Amount of Payments to Vendors Less Than \$25,000	Zero payments to vendors less than \$25,000 were reported although there were 15 individual vendor payments less than \$25,000 each (totaling \$41,785) at September 30, 2010. The data remained unreported at December 31, 2010.
Recipient Report Requirement - Sub-Recipient Information	The Department reported zero sub-recipient information for Habitat for Humanity at September 30, 2010; however, information was reported at December 31, 2010.
Recipient Report Requirement - Total Federal Amount ARRA Funds Received/Invoiced	The reported total Federal amount of ARRA funds received/invoiced was overstated by \$107,857.
Whistleblower Protection - Signage of specific Recovery Act Whistleblower protections must be posted at all Recovery Act job sites.	Not only was the Whistleblower Rights poster not posted at all job sites, Management was unaware of this Recovery Act requirement.

**Recommendations to Issue #2:**

- 5) Review the Office of Budget and Management (OMB) Guidance and obtain extensive training on Recovery Act requirements.
- 6) Ensure information reported on the Recipient Report is complete, accurate, and supported in accordance with the OMB.
- 7) Post the required Whistleblower Protections sign at all job sites.



## Appendix A

### Management's Response

### Department of Development Services



**Date:** April 15, 2011  
**To:** Laura L. Doud, City Auditor  
**From:** Amy J. Bodek, Director of Development Services  
**Subject:** Management Response to the Department of Development Services Neighborhood Stabilization Program 2 (NSP2) Recovery Act Compliance Audit

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The Department of Development Services (Department) recently worked with the City Auditor's Office (Auditor) during an audit of the Neighborhood Stabilization Program 2 (NSP2). The Department would like to thank the Auditor for the time they committed to performing a thorough review of this complex program.

The Department would like to take this opportunity to provide some facts about the program and the way it has evolved. When the first two rounds of Neighborhood Stabilization funding were released, the U.S. Department of Housing and Urban Development (HUD) conveyed that both rounds were intended to be used immediately to stabilize neighborhoods by stemming the tide of foreclosed properties and providing opportunities for home ownership.

NSP2 program requirements were initially established within a framework that was closely modeled after the structure of the long-established Community Development Block Grant (CDBG) program. As the program has progressed, HUD has issued dozens of policy alerts and other forms of guidance, which clarified and in some cases revised the program regulations. Coupled with an actively updated Technical Assistance website titled the NSP Resource Exchange (located at <http://hudnsphelp.info/index.cfm>), the 143 pages of guidance issued to date have served to assist staff in fine-tuning the NSP2 program and ensuring compliance with the rules that govern it. Staff respectfully requests that the issues referenced in the Auditor's Report (Report) acknowledge the difficulties inherent in working with a program that was being fine-tuned on both a federal and local level during the time of the audit.

The Report outlines several issues, many of which staff believe were a result of the continuous development of the NSP2 program, which have since been resolved and refined to ensure a more efficient level of compliance with regulations. The issues are discussed specifically in more detail below.

**Issue #1 - Procurement Practice Needs To Be More Aligned With Federal Regulations**

As documented in the Report, the Auditors assessed the NSP2 contractor selection process during the time it was being developed. The Report, however, does not reference the initial Request for Qualifications (RFQ) process that was



conducted by the Neighborhood Services Bureau to select a group of qualified contractors, which resulted in a list of 25 vendors. After the RFQ process, each home was inspected by both City Staff and a consulting Construction Management Firm, who then created a work write up that reflected the findings of these inspections. Bids were then solicited from the contractor list and all bids received were then compared to the cost-analysis/work write up.

During the initial development of the NSP2 procurement process, staff believed that the RFQ process was sufficient to meet the federal regulations, which requires solicitation from an "adequate number of qualified sources" (see 24 CFR Part 85.36(4)(d)(2) - Small Purchase Procedures). Staff presented a detailed procedure for the selection of contractors to the HUD field office. After checking with HUD staff, City staff realized that this process required further refinement, and therefore revised the policy to ensure that three bids would be solicited from the RFQ respondents. Despite attempts to solicit multiple quotes, staff frequently found that only one or two contractors would respond to the solicitation. In these instances, the attempts to request quotes, along with the lack of response, has been documented in the program files and does comply with HUD's regulations (24 CFR Part 85.36(4)(d)(4)), which states that a contract may be awarded if "after solicitation of a number of sources, competition is deemed inadequate."

After the Auditor's review, staff realized that while the process was aligned with federal regulations, it was not in line with the City's Purchasing Policies. To remedy this issue and ensure the receipt of three quotes, staff requested the assistance of the Purchasing Division to perform outreach to contractors outside the current 25-vendor list. While the process has not been perfect, it has been fair and competitive, and it has evolved into a sensible process that utilizes the expertise of multiple agencies, including HUD, the City Attorney, the City Auditor, and the City's Purchasing Division.

#### **Issue #2 - Lack of Compliance with American Recovery and Reinvestment Act Requirements**

The Department concurs with the Auditor's conclusion relating to the unprecedented levels of reporting and transparency required by the American Recovery and Reinvestment Act (ARRA) for the NSP2 program. Staff has worked diligently to learn the intricate details of these requirements and to incorporate tools to ensure consistent, accurate, and timely reporting using the federal government's resources located at [www.federalreporting.gov](http://www.federalreporting.gov).

As with the program design elements, the ARRA reporting requirements culminated in the issuance of numerous pages of guidance and presented staff with the challenge of interpreting the requirements. Since the audit, staff has come to understand the regulations and guidance provided by the Office of Management and Budget (OMB) and has designed a thorough checklist and

review process. The OMB Guidance gives several provisions related to errors in terms of compliance and materiality.

In the OMB Memorandum, M-10-08 dated December 18, 2009, the office confirms that, with the exception of the job reporting field, the fields containing errors as mentioned in the Report are not considered "Significant Errors." The guidance further states that the consequences of errors would only result in the termination of federal funding if the recipient demonstrated systemic, chronic, or intentionally fraudulent reporting practices. Because the specific errors were the result of reasonable assumptions and because the reporting process has since been updated, staff feels this issue has been addressed. Moreover, the OMB's reporting Frequently Asked Questions (FAQ) states that errors discovered after quarterly reports are filed will be corrected by the filing of subsequent reports, because all reports are cumulative.

The specific ARRA reporting errors outlined on the Report include the following:

- Recipient Report Requirement - Number of Jobs Created (reported in FTE's)
  - The CDBG guidelines related to job retention specifically state that in order for a job to be considered a retained FTE, the grantee must have factual documentation supporting that the position would have been eliminated without the use of grant funds. Staff's original interpretation of this field as it relates to ARRA funding was driven by this understanding and therefore did not include FTE counts for jobs held by City staff. Although no FTE's were reported on the initial quarterly reports, staff had already developed a form to be used to collect job retention and creation information from rehabilitation contractors. As described in the Report, this issue was remedied beginning with the Q4, 2010 quarterly report, when staff began to include job retention calculations for existing City staff.
- Recipient Report Requirement - Total Number and Amount of Payments to Vendors Less than \$25,000
  - The vendor payment section was not completed on the quarterly reports reviewed by the auditors; however, staff has reviewed this requirement and began reporting this data in the Q1, 2011 quarterly report. The information was not reported in prior quarters in part because the instructions listed at the [www.federalreporting.gov](http://www.federalreporting.gov) website include a link to a reporting template that lists the vendor section as "Optional". This template was available for download as recently as March 2, 2011, and led staff to believe that this field was not required. Further investigation of the FAQ and discussions with the HUD NSP2 coordinator have helped staff to clarify this issue. Staff has



incorporated this data, including the cumulative totals as calculated from inception to date, in the current report and will continue to do so in the future.

- Recipient Report Requirement – Sub-recipient Information
  - Habitat for Humanity is not truly a sub-recipient of the City of Long Beach. All of HUD's guidance confirms that Consortium Partners are not sub-recipients, so staff did not report them as such on the Q3, 2010 quarterly report. Since that time, staff has read additional guidance and confirmed that while Habitat is not a sub-recipient of the City, they should be treated as such for the quarterly reporting process. Please note that while staff did not include the data for Habitat for Humanity on the sub-recipient reporting tab, all required data regarding their activities was included on the Prime Recipient section of the report. As described in the Report, this issue has been corrected beginning with the report filed for December 31, 2010.
- Recipient Report Requirement - Total Federal Amount ARRA Funds Received/Invoiced
  - An error occurred in the Q3, 2010 ARRA reporting completed on October 7, 2010, due to a misunderstanding of the appropriate definition for the field entitled "Total Federal Amount ARRA Funds Received/Invoiced". The instructions related to this field state to "enter the amount of Recovery Act funds received through draw-down, reimbursement, or invoice." Staff's understanding of this phrase at the time was that the term "invoice" would include expenses incurred using ARRA funds but not yet received in a draw-down; therefore, we reported a number that was equal to the expenses in FAMIS as of that date (10/07/2010). The \$107,857 that the Auditor considers "overstated" were ARRA funds that had been expended by the City, although they had not yet been reimbursed from ARRA funds. These amounts can be verified by examining the expense transactions that have a posting date prior to October 8, 2010.

As of the Q4, 2010 report, staff has used and will continue to use the draw-down totals, as submitted in the concurrent period's Quarterly Performance Report prepared for HUD.

- Whistleblower Protection - Signage of specific Recovery Act Whistleblower protections must be posted at all Recovery Act jobs sites.
  - The Whistleblower Protection provisions were understood and were followed by management, as they understood the regulation during the time of the audit. Posters regarding the Whistleblower provision were posted at the offices of the Neighborhood Services Bureau

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and language regarding the provision was posted on the Bureau's NSP2 website with links to the City Auditor's fraud hotline. The poster was not displayed at one rehabilitation job site, which was the first rehabilitation contract executed under NSP2. Because the rehabilitation project was at an occupied residence, rather than a public infrastructure project, and staff believed that posting signage at an individual's private property may infringe upon the homeowners right to privacy. Based on communications with the Auditor's office and with HUD staff, City staff are working on developing a compromise that will allow the posting to be displayed at a job site, while still being sensitive to the homeowner's right to privacy.

The Department has carefully reviewed the recommendations provided by the Auditor and has taken steps to either incorporate them or to mitigate the issues that led to the concerns. The Department appreciates that the Auditor has provided this opportunity to address the Audit Report directly.

For further information regarding this topic please contact Angela Reynolds, Manager, Neighborhood Services Bureau at ext. 8-6369.

AJB:AR:AH:aa

Management Response to Audit Comments v8

CC: Angela Reynolds, AICP, Neighborhood Services Bureau Manager