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TO: Milan Ozdinec
Deputy Assistant Secretary for Public Housing Investments, PI

Diana Armstrong
Director, Office of Public Housing, 6JPH

FROM: D. Michael Beard
Regional Inspector General for Audit, 6AGA

SUBJECT: San Antonio Housing Authority
HOPE VI Program
San Antonio, Texas

INTRODUCTION

In response to a Congressional request, we have completed an audit of the HOPE VI Programs of the San Antonio Housing Authority (SAHA). Our objectives were to determine: (1) whether inferior workmanship and substandard materials were used in construction of Mirasol Homes (Mirasol) single family homes; (2) whether the land on which Mirasol is built contains pollutants and caused residents' illnesses; (3) how SAHA awarded the single family contract for Mirasol; and (4) whether SAHA properly accounted for Mirasol and Springview expenditures.

Congressman Charles Gonzalez received many complaints regarding inferior workmanship and substandard materials, as well as concerns regarding the land on which Mirasol Homes were built. Specifically, the complaints alleged:

- Particle board being used instead of real wood in the cabinets;
- Door hinges placed on the outside of doors, making them susceptible to criminal entry;
- Light switches placed on a wall so the switch is blocked when a door opens;
- The placement of water heaters and air conditioning units in the same closet;

- Homes with no back windows and doors; and
- Residents attributing their illnesses to pollution from a former landfill on which the homes were built.

Congressman Gonzalez also indicated his concern over the management of the project and requested a financial audit of two HOPE VI housing projects, Mirasol and Springview. We designed our objectives based on his request.

To accomplish our objectives, we interviewed:

- Current and former SAHA employees;
- The Mayor of San Antonio;
- The SAHA's environmental contractor;
- Employees of the Texas Commission on Environmental Quality;
- Architects that designed the day care center and administration building on Mirasol;
- Alamo Area Council of Government employees;
- Fee attorneys for SAHA;
- Former employees of Mirasol Joint Venture Team (Joint Venture) and its subcontractors;
- Inspectors with the Corps of Engineers who conducted inspections on behalf of HUD throughout the construction of the project;
- SAHA's project manager for Mirasol; and
- Department of Housing and Urban Development employees.

Further, we reviewed:

- Texas Administrative Code regarding environmental issues;
- Legal documents regarding a potential lawsuit;
- Invoices for architectural designs on the old landfill;
- Environmental Assessment Reports prepared by SAHA environmental contractors;
- Construction documentation, including inspection reports and follow-up inspection reports, prepared throughout construction by the project manager, Heery International, and the Corps of Engineers who did the inspections for HUD;
- An independent report on the quality of construction; and
- A statistical sample of accounting records maintained by SAHA on the expenditures for the Mirasol and Springview HOPE VI projects. We used the monetary unit statistical sample method with a 95 percent confidence level to project the results of our test. Further explanation of the test is contained in our finding.

We also conducted on-site visits of Mirasol. Our scope included SAHA activities related to the construction of the single family homes from January 1995 to July 2003. We expanded the scope as necessary to include the buildings that SAHA originally planned

to construct on the old landfill site. Further, we reviewed the contracting process between SAHA and the Joint Venture from contract award in July 1999 through execution of the contract in December 1999. We conducted the audit in accordance with Generally Accepted Government Auditing Standards.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, 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. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. 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, Assistant Regional Inspector General, Jerry R. Thompson or me at 817-978-9309.

SUMMARY

Congressman Charles A. Gonzalez and Congressman Barney Frank requested the Inspector General to review allegations concerning the quality of construction, workmanship, and materials used for Mirasol and whether the expenditures for the Mirasol and Springview HOPE VI projects were accounted for adequately. Specifically, our objectives were to determine: (1) whether inferior workmanship and substandard materials were used in construction of Mirasol single family homes; (2) whether the land on which Mirasol is built contains pollutants and caused residents' illnesses; (3) how SAHA awarded the single family contract for Mirasol; and (4) whether SAHA properly accounted for Mirasol and Springview expenditures.

Regarding some of the Congressmen's specific concerns, our review disclosed that the SAHA value-engineered¹ the use of particle board cabinet doors instead of real wood doors as required in the Request for Qualifications, placed certain door hinges on the outside of doors, place water heaters and air conditioning units in the same closet, and constructed certain homes without back windows and doors. We found that although these construction methods may sound substandard, they meet San Antonio building codes and are consistent with acceptable industry practice in the area.

Further, SAHA placed non-removable hinges in the outside doors. The back doors and windows were placed on the side of the homes to afford better furniture placement. The placement of the air conditioner and water heater in the same closet is a method used in other non-government related subdivisions in the City by the contractor. We could not

¹ Value Engineering is a function-oriented, systematic team approach to provide value in a product, system, or service. Often, this improvement is focused on cost reduction; however, other improvements such as customer perceived quality and performance are also paramount in the value equation.

find an instance where the contractor placed the light switches so the switches were blocked when a door is opened.

The single family contractor has recently agreed to install windows in the back of the houses and place a bilingual maintenance person on-site at Mirasol for 3 years at no cost to SAHA.

The Authority had planned to build on a former landfill but after testing the site the Authority officials decided to change their plans. SAHA entered into a Voluntary Cleanup Agreement with the State of Texas. The Texas Commission on Environmental Quality (Commission) has investigated and is continuing to investigate the landfill pollutants. Also, the Commission is monitoring the action to clean up the landfill. According to Commission officials, tests showed that most of the contamination is in or near the landfill footprint. They further said, based on tests to date, the residents of the project are not threatened as long as they use City water and do not use ground water.

SAHA officials limited competition when awarding the contract for the Mirasol development. Further, SAHA unnecessarily spent, or cannot support \$3,895,441 in HOPE VI funds. Specifically, SAHA inappropriately incurred \$1,861,852 in HOPE VI funds to design part of the Mirasol development on land that had previously been used as a public landfill; cannot support \$2,022,977 in payroll expenses; and overpaid the Joint Venture \$10,612 in overhead and profit on change orders. SAHA officials were either unaware of or ignored federal and State environmental requirements, made mistakes in calculating payments, and did not require retention of adequate expense documentation. As a result, almost \$4 million in HOPE VI expenditures is ineligible or unsupported.

We provided a copy of our draft report to SAHA officials on March 23, 2004. We had an exit conference and they provided their written comments on April 2, 2004. They concurred with part of the report and did not concur with other parts of the report. They provided additional documentation on the unsupported costs. We reviewed the documentation and made adjustments to the draft where necessary. We recognize their comments and provide our evaluation beginning on page 11 in the finding. We have included their complete written comments without the attachment, which contained employee personal information, as Appendix B.

BACKGROUND

The City of San Antonio established SAHA under Texas statute in 1937. The Authority administers 6,363 units of public housing and 11,505 Section 8 vouchers. In June 2003, at the request of the San Antonio Mayor, the 11-member SAHA Board of Commissioners disbanded. From June until August 2003 the Board consisted of five interim members. On August 27, 2003, the San Antonio Mayor announced a permanent seven-member Board for SAHA. The President/Chief Executive Officer is in charge of day-to-day operations. SAHA is located at 818 South Flores in San Antonio, Texas.

On February 1, 1995, HUD awarded SAHA \$48,285,500 to rebuild Mirasol under the HOPE VI Program. Previously Mirasol consisted of 500 units constructed in 1952. SAHA demolished these 500 units in 1998. The redevelopment of Mirasol is comprised of 87 single family houses, 20 cottages, 67 townhomes, administration and multipurpose building, health center, and day care center. Off-site is comprised of 56 elderly apartments and 160 single family houses.

SAHA prepared and issued a Request for Qualifications for a design builder contract to construct single family homes in May 1999. SAHA required responses back on June 3, 1999. Only two firms responded with proposals. SAHA conducted interviews on June 16, 1999. SAHA's Board approved the proposal of Mirasol Joint Venture Team comprised of Magi Realty, KB Homes, East West Designs,² and Qzuna & Associates Consulting Engineers.

On September 7, 1994, HUD awarded SAHA \$48,810,294 to rebuild Springview under the HOPE VI Program. Previously Springview consisted of 421 units. SAHA constructed 108 public housing apartments, 40 senior apartments, and 25 assisted living units on the Convent property. In addition Springview consists of 46 market rate single family houses, as well as 10 Public Housing single family houses. Phase II and III of the single family subdivision is not completed. Additionally, there were 21 houses built at scattered sites and 59 senior resident units.

FINDING

\$4 Million in HOPE VI Expenditures is Ineligible or Unsupported.

SAHA unnecessarily spent or cannot support \$3,895,441 in expenditures of HOPE VI funds. Specifically, SAHA used \$1,861,852 in HOPE VI funds to (contrary to State law) design part of the Mirasol development on land that had previously been used as a public landfill; cannot support \$2,022,977 in payroll expenses; and overpaid the Joint Venture \$10,612 in overhead and profit on change orders. Also, SAHA officials limited competition awarding the contract for the Mirasol development. SAHA officials were either unaware of or ignored federal and State environmental and contracting requirements, made mistakes in calculating payments, and did not require retention of adequate expense documentation. As a result, almost \$4 million in HOPE VI expenditures is ineligible or unsupported.

The Grant Agreement Article IV 11(d) requires SAHA to follow requirements of Office of Management and Budget (OMB) Circular A-87.³ Further, Article VI of the Grant Agreement states: "The Grantee will not carry out activities with respect to development under this Grant Agreement, except for activities described in 24 CFR 50.19 (b) – (h) or

² On July 7, 1999, WestEast Designs resigned and the Joint Venture replaced them with Bartholomew & Associates Architects.

³ Cost Principles for State, Local, and Indian Tribal Governments.

50.20, until written approval under the applicable environmental requirements of 24 CFR part 50 is received from HUD.” The grant agreement also stipulates standard procurement requirements that include full and open competition when awarding contracts.

OMB Circular A-87, Attachment A, Section C. 1 provides factors affecting allowability of costs. To be allowable under federal awards, costs must, among other things:

- Be necessary and reasonable for proper and efficient performance and administration of federal awards;
- Be allocable to federal awards under the provisions of this Circular;
- Be authorized and not prohibited under State or local laws or regulations;
- Conform to any limitations or exclusions set forth in these principles, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of costs items; and
- Be adequately documented.

Texas Administrative Code §330.953 states that a person may not undertake the development of a track of land that is greater than 1 acre in area unless the person conducts a soil test prior to or during development and construction. The soil test is intended to determine whether a landfill exists on the property planned for development. Section 330.951 defines “development” as any activity on or related to real property that is intended to lead to the construction or alteration of an enclosed structure for the use and/or occupation of people for an industrial, commercial, or public purpose or to the construction of residences for three or more families, including subdivisions that will include single family homes and duplexes.

SAHA unnecessarily spent over \$1.8 million due to plans to build on the landfill.

SAHA unnecessarily spent HOPE VI funds to plan part of the Mirasol development on land known as Parcel B that had previously been used as a public landfill. The development never reached the construction phase. The landfill was sufficiently hazardous to prevent construction on top of it. Although contrary to environmental laws, SAHA developed and pursued plans to build on land without investigating the land’s previous use. This occurred because SAHA was either unaware of or ignored federal and State environmental requirements. As a result, SAHA incurred and charged the HOPE VI Program \$1,861,852 in costs that were not allowable under the program and may incur additional costs for methane testing and mitigation.

SAHA officials should have known about the landfill in January 1995 and, at that time, should have taken appropriate measures to complete environmental testing or changed their plans to build on it. The Housing Authority had tests done on the land to determine the type of foundation required for the buildings. The tests determined there was a landfill with unknown material and recommended additional tests be performed to determine the contents of the landfill.

It was not until 1999 when the Housing Authority had tests done on the landfill contents. The contents consisted mainly of glass, nylon hosiery, aluminum scrap, wire, PVC pipe, copper scrap, socks, rubber, and nails. Through a consultant, the Housing Authority contacted the Texas Commission on Environmental Quality (Commission). The Commission recommended the landfill be capped and not be used to build on. The Commission has investigated and is continuing to investigate the landfill pollutants. Also, the Commission is monitoring the action to clean up the landfill. According to Commission officials, tests showed that most of the contamination is in or near the landfill footprint. They further said, based on tests to date, the residents of the project are not threatened as long as they use City water and do not use ground water. They still plan to require further soil and ground water tests and tests for methane gas.

The Authority officials changed their plans to build on Parcel B in 2000 and entered into a voluntary cleanup program agreement with the Commission. By this time they had unnecessarily spent or had committed to spend HOPE VI funds shown in the following table.

| Ineligible Expenses | |
|------------------------------------|--------------------|
| Project Manager Contract Extension | \$1,037,000 |
| Parcel B Design | 340,255 |
| Stockpiled Soil | 243,976 |
| Delay Claim | 207,574 |
| Rezoning and Replatting | 33,047 |
| Total | \$1,861,852 |

SAHA did not submit an environmental assessment to HUD until November 2001. HUD did not approve it until January 2003 because of processing requirements according to HUD. This was after SAHA had changed its plans to build on Parcel B.

SAHA spent \$1,037,000 to extend the project manager’s contract.

In December 2000 and again in May 2002, SAHA extended its project manager’s contract because of delays related to the old landfill. SAHA paid \$1,037,000 in these contract extensions. Specifically, SAHA paid \$850,000 in December 2000 and \$187,000 in May 2002. SAHA would not have incurred these contract extension costs if it had performed the environmental testing timely.

SAHA spent \$340,255 for designing buildings on the landfill.

From January 1995 through August 2000, architects under contract with SAHA kept designing buildings to be built on Parcel B. Texas State code states that all activity including designing must cease once a potential landfill is discovered. SAHA incurred \$340,255 of these types of expenses.

Specifically, according to the architect that designed the townhomes and administration building the actual design of the structures did not change from its design on Parcel B to where SAHA eventually constructed it. However, civil, structural, mechanical, electrical, and plumbing engineering and landscape architecture did change. SAHA expended \$32,220 and \$22,500 on these types of expenses for the townhomes and administrative building, respectively.

SAHA did not construct the Avance childcare center because of mounting environmental expenses. SAHA paid the architect designing the Avance childcare center \$63,706 in expenses that should not have been paid.

SAHA did construct a day care center for Parent Child Inc. at Mirasol across the street from Parcel B that it originally planned to construct on Parcel B. SAHA incurred \$58,910 of architectural design costs while planning to construct this day care on Parcel B.

SAHA amended the medical center architect's contract by \$40,560 to coordinate civil engineering between the medical center and administrative building. Further, SAHA paid the medical center contractor an additional \$122,359 to construct the interface site work. SAHA would never have incurred these costs if the proper environmental studies had been done timely and the medical center had not been planned for Parcel B.

SAHA spent \$243,976 to fence in and test stockpiled soil.

During demolition and excavation, and before the Authority entered the voluntary cleanup program agreement, contractors stockpiled soil on Parcel B. The Texas Commission on Environmental Quality required SAHA to fence in and test the stockpiled soil. SAHA used \$243,976 in HOPE VI funds to fence in Parcel B and test the stockpiled soil for contaminants. This should not have been a HOPE VI expense.

SAHA paid the Joint Venture \$207,574 in a delay claim.

The Joint Venture submitted a delay claim to SAHA as a result of delays caused by not building on Parcel B. In Change Order 13, SAHA gave the Joint Venture an additional 171 working days to complete construction. However, the Joint Venture also wanted overhead and lost wages. After months of discussion, SAHA's Board agreed to pay the Joint Venture \$207,574. SAHA would never have incurred this cost if it had completed the environmental testing in a timely manner, as required.

SAHA spent additional \$33,047 for rezoning and replatting expenses.

In 1999 SAHA received a waiver from the City of San Antonio for zoning and platting fees. However, SAHA changed its plans to build on Parcel B because of environmental concerns. If SAHA had included the final plans in its original zoning and platting request, the fees may have been waived. However, SAHA paid \$33,047 for rezoning and

replating at a later date and incurred additional expenses that SAHA paid from the HOPE VI grant.

SAHA cannot support expenses.

SAHA cannot support payroll expenses for Springview and Mirasol. SAHA is unable to locate the supporting documentation. OMB Circular A-87⁴ states that in order for costs to be allowable, they must be adequately documented. Based on projecting the error rate to the universe, we estimate SAHA cannot support about \$2,022,977. SAHA needs to provide adequate support to HUD for all of its payroll expenses or repay the HOPE VI grants \$2,022,977 from non-federal funds.

We examined a statistical sample of expenditures using the monetary unit sample method with a 95 percent confidence level. The monetary unit sampling method biases higher valued items for selection. A million-dollar item is more likely to be selected for review than a hundred-dollar item. The chance of an item being selected is directly proportional to its size.

Universe and Sample Data

| Sample Type | Universe Amount | Selected Sample Size | Unsupported Amount | Error Rate Percentage |
|---------------------------------|------------------------|-----------------------------|---------------------------|------------------------------|
| Mirasol Non-Payroll Expenses | \$43,822,903 | \$23,828,523 | \$2,209 | Less than 1 percent |
| Mirasol Payroll Expenses | \$1,583,798 | \$66,718 | \$25,817 | 39 percent |
| Springview Non-Payroll Expenses | \$42,901,252 | \$10,342,378 | \$0 | None |
| Springview Payroll Expenses | \$2,342,160 | \$100,282 | \$60,606 | 60 percent |

SAHA cannot support Springview and Mirasol payroll amounts, totaling \$60,606 and \$25,817, respectively. These amounts exceed the expected error rate of 5 percent of the statistically selected sample. Thus, the projected error amount to the total universe is \$1,405,296 for Springview and \$617,681 for Mirasol. This totals \$2,022,977.

SAHA limited competition on the Mirasol development contract.

SAHA limited competition when awarding the Mirasol development contract. This was apparently due to the lack of contracting experience or actions of responsible personnel. The Request for Qualifications referred to financing by the successful bidder. The

⁴ In Attachment A, Part C "Basic Guidelines", Subpart 1.j.

Request attracted only two bidders. Other contractors we contacted stated they would have bid on Mirasol if the financing requirement had not been included.

In 1997, SAHA's Vice President of Investment Initiatives⁵ contacted KB Homes and initiated a standing commitment to construct homes at Menchaca. At the time SAHA sought another HOPE VI grant to construct these homes. SAHA did not receive this grant, but the Menchaca homes were included in the Mirasol HOPE VI grant.

In 1999, SAHA issued a Request for Qualifications for a design builder to construct 258 single family homes for the Mirasol HOPE VI grant. One of the largest evaluation and ranking criteria included the bidders' financial approach. The Request for Qualifications stated that highest consideration would be given to the proposal with the best overall response including financing.

In the Joint Venture's proposal it stated one of its joint venture team members (KB Homes) financed over \$1 billion in homes in 1998. The Joint Venture relied upon KB Homes' financial ability to win the Mirasol contract. In its proposal it stated that the Joint Venture has the capability and intention of providing up to 100 percent interim financing. However, after SAHA selected the Joint Venture, it did not sustain this level of financing.

SAHA allowed the Joint Venture to draft the single family construction contract. The contract signed by SAHA and the Joint Venture contained a clause requiring a payment for each house only after substantial completion for the 160 off-site houses. The Request for Qualifications stated that houses constructed on the Mirasol site would be paid with progress payments. This meant the Joint Venture funded off-site construction until SAHA agreed that the houses were substantially complete. However, the contract did not define the term "substantial completion." Although the Joint Venture originally agreed to the financing clause in the contract, this changed during construction to progress payments for off-site houses.

Because SAHA could not construct on Parcel B, the Joint Venture began construction of the off-site properties first. This meant the Joint Venture received no payments until construction completion. Because it took so long for SAHA and the Joint Venture to agree to what substantial completion meant and for the Joint Venture to begin receiving payments, SAHA and the Joint Venture amended the contract to allow progress payment for the off-site houses. We contacted other contractors who picked up Request for Qualifications packages to find out why they did not respond to the Request. They stated they would have responded if the financing requirement had not been included. Therefore, the financing clause contributed to the limited competition.

SAHA did not adhere to contract terms.

SAHA paid the Joint Venture \$10,612 in excessive overhead and profit related to change orders. This amount paid included 30 percent overhead and profit but the contract only

⁵ At this time Investment Initiatives oversaw the HOPE VI grants.

allowed for 20 percent. Therefore, SAHA needs to request repayment from the Joint Venture and repay the Mirasol HOPE VI grant account \$10,612 for the overpayments. The following table summarizes the change orders and the overpayments related to each.

Ineligible Change Order Payments

| Change Orders | Total Amount Invoiced ⁶ | Amount Invoiced with 20 Percent Overhead and Profit ⁷ | Ineligible Amount ⁸ Due to Over payments |
|---------------|------------------------------------|--|---|
| 1 | \$42,821 | \$40,819 | \$2,002 |
| 2 | \$18,628 | \$17,195 | 1,433 |
| 3 | \$20,901 | \$19,293 | 1,608 |
| 4 | \$14,454 | \$13,342 | 1,112 |
| 5 | \$22,250 | \$20,160 | 2,090 |
| 6 | \$14,300 | \$12,960 | 1,340 |
| 7 | \$24,000 | \$23,790 | 210 |
| 8 | \$20,800 | \$20,387 | 413 |
| 9 | \$19,200 | \$19,032 | 168 |
| 12 | \$867 | \$840 | 27 |
| 19 | \$2,730 | \$2,520 | 210 |
| Total | | | \$10,612 |

AUDITEE COMMENTS

SAHA officials concurred with the draft finding except in regard to the following matters:

SAHA officials said they acknowledge the lack of action in response to early indications of an environmental concern but disagree with OIG labeling the \$1,861,852 as ineligible payments. They said if the impact study had been done in 1995 – 1997, many of the Mirasol-related hardships, delays, and expenses would have been avoided. The impact of these events led to the unanticipated expenditure of more than \$2 million to-date. They said after other SAHA officials discovered the environmental conditions in 1999, SAHA and HUD had only two options: to abandon the project and walk away from the community; or to take the necessary action to move the project forward. All parties involved decided to serve the community. They monitored the environmental impact, revised the master plan to relocate buildings, extended contracts, and ultimately built apartments and homes.

SAHA officials stated the part of the finding stating that payroll costs for Springview and Mirasol cannot be supported is incorrect because, due to their short deadlines, the auditors were unable to review all available support documentation. Also, they said the sampling and projection technique used may not have been appropriate.

⁶ Amounts rounded to nearest dollar.

⁷ Ibid.

⁸ Ibid.

SAHA officials said the audit occurred during a peak work period for SAHA. Finance and Accounting personnel were simultaneously working on the OIG audit, the annual external audit, an FDS data submission, and yearend payroll reporting. The audit covered a 10-year period and SAHA personnel attempted to provide all requested documentation. SAHA was unable to provide all requested data prior to the day the auditors completed the fieldwork. SAHA officials said they subsequently found additional payroll documentation they feel would support the transactions questioned. They also indicated independent auditors have audited these accounts and were satisfied with the documentation.

SAHA questioned the sampling process, indicating the sample may not have been representative of the population of payroll records, so it would be difficult to draw conclusions from the sample. Also, the projection of an error rate may have included individually significant items that should not be projected to the population when using accepted audit procedures. SAHA officials said the larger the sample, the more closely it depicts the population; however, the monetary unit sample method tends to focus on a smaller sample size and has a bias toward large but infrequent errors. They said audit procedures normally require removal of individually significant items prior to projecting the sample results to a population and they do not believe this was done.

SAHA officials said one employee whose salary was included in the questioned cost spent all of his time on HOPE VI projects. They also said the auditors questioned a payroll item that they have now determined is not related to HOPE VI and should be removed from the audit sample.

SAHA officials disagreed with the finding that they limited competition when awarding the Mirasol development contract. They said the finding makes unsubstantiated assumptions that are wholly unrelated to the facts and scope of this audit, and should therefore be deleted. SAHA officials said it needed to procure a builder with the financial and organizational resources to produce 247 single family homes in a short amount of time. The financial requirements were sound and well within procurement policies. SAHA officials said they acknowledge that the requirement to demonstrate a strong financial capacity may have led to the decision on the part of some builders not to respond to the Request For Qualifications but it did not violate any procurement laws. It was not the intent to discourage bidder participation. SAHA officials remain convinced it was a necessary and responsible requirement.

SAHA officials said they are still researching the \$10,612 payments to the Joint Venture in excess overhead and profit but if they verify the payments were in excess of the contract terms, they will seek repayment.

SAHA officials provided information regarding a part of the draft finding that questioned \$4,581 of HOPE VI funds to pay expenses of another project. The information provided showed the project was originally being considered as part of Mirasol but was later deleted.

OIG EVALUATION OF AUDITEE COMMENTS

As stated in the finding, OMB Circular A-87 requires costs to be necessary and reasonable for proper and efficient performance and administration of federal awards, to be allocable to federal awards under provisions of this circular, be authorized and not prohibited under State or local laws or regulations, and be adequately documented. Texas State law requires soil tests to be conducted before any development of a track of land larger than 1 acre.

SAHA officials' comments on the costs incurred as a result of their delayed action on the environmental problem do not change our conclusions. They charged costs to the HOPE VI grant that were contrary to OMB Circular A-87 and Texas State law. Therefore, the costs are ineligible. HUD did not agree to having unnecessary or ineligible costs charged to the HOPE VI grant.

At the exit conference, we obtained the additional payroll documentation SAHA indicates would support the questioned payroll costs. Some of the documentation was adequate and we changed the amount we questioned. However, much of the documentation is still inadequate. Although one employee may work only on HOPE VI projects, if there are two or more grants, the employee costs must be charged based on actual time spent on each grant. The timesheets provided by SAHA did not show the projects on which the employees worked. When an employee worked on two or three projects with different cost accounts, SAHA officials charged the costs to the projects based on a predetermined budgeted percentage and not on the basis of the actual amount of time spent working on the project. This is contrary to OMB Circular A-87 that provides that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federal awards.

We believe our sample is reliable. The comments by SAHA officials did not change our opinion on the sample. We did not include any transaction that had not been charged to the HOPE VI grants. The Office of Inspector General uses computer software for monetary unit sampling and it does bias selections of transactions with a higher unit value. We obtained all HOPE VI grant transactions from SAHA electronically and applied the software to select our sample. Such a sample provides a high level of assurance that significant items in the population are subject to testing. This also provides an adequate confidence level that the sample is representative of the universe as a whole.

We made minor revisions to the part of the draft finding indicating SAHA officials limited competition when awarding the Mirasol development contract; however, our conclusion remains much the same. Title 24, CFR, part 85.36 states that all procurement transactions will be conducted in a manner providing full and open competition consistent with standards. The fact remains the Request For Qualifications attracted only two responses. The Request indicated the successful contractor would possibly be

required to finance the construction until substantial completion. This reduced the number of responses. However, SAHA and the successful bidder agreed on progress payments before substantial completion of the project.

In response to SAHA's comments and the additional information provided, we deleted the part of the draft finding that questioned \$4,581 in HOPE VI funds used on the Christ the King development.

RECOMMENDATIONS

We recommend HUD require SAHA to:

- 1A. Implement procedures to ensure compliance with all environmental requirements for any future grants.
- 1B. Ensure the proper contracting procedures are followed to ensure full and open competition.
- 1C. Reimburse the HOPE VI grant account \$1,861,852 for ineligible payments made with HOPE VI grant funds.
- 1D. Support with adequate documentation all of its payroll expenses charged to the HOPE VI grants or reimburse the HOPE VI grant funds \$2,022,977 (\$1,405,296 for Springview and \$617,681 for Mirasol) for unsupported payroll charged as HOPE VI grant expenses.
- 1E. Reimburse the Mirasol HOPE VI grant account \$10,612 for ineligible change order payments paid with HOPE VI grant funds.

MANAGEMENT CONTROLS

Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

We determined that the following management controls were relevant to our objectives:

- Grant Agreements
- Environmental requirements
- Contracting procedures

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses, which are covered in our finding.

- The Authority failed to follow the grant agreement and environmental requirements.
- The Authority charged ineligible and unsupported costs to the Grant.
- The Authority limited competition when contracting for the development Mirasol.

SCHEDULE OF QUESTIONED COSTS

| <u>Recommendation Number</u> | <u>Type of Questioned Cost</u> | |
|----------------------------------|--------------------------------|--------------------------------|
| | <u>Ineligible¹</u> | <u>Unsupported²</u> |
| 1C | \$1,861,852 | |
| 1D | | \$2,022,977 |
| 1E | <u>10,612</u> | |
| Totals | <u>\$1,872,464</u> | <u>\$2,022,977</u> |

¹ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.

² Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

AUDITEE COMMENTS



**Response to the Draft Audit Report
HOPE VI – Mirasol & Springview
by the
Office of the Inspector General**

April 2, 2004

The report by the Office of the Inspector General (OIG) cites one of their objectives to be to determine whether inferior workmanship and substandard materials were used in the construction of the single-family homes at Mirasol.

The OIG investigation stated: *SAHA value-engineered a number of items in the homes, defining value-engineering as “a function-oriented, systematic team approach to provide value in a product, system or service. Often, this improvement is focused on cost reduction; however, other improvements such as customer perceived quality and performance are also paramount in the value equation.”*

The OIG report concluded: *Although these construction methods may sound substandard, they meet San Antonio Building Codes and are consistent with acceptable industry practice in the area.*

SAHA Response: SAHA concurs with this finding.

In addition to the childcare facility, administration/community building, health care center, 67 townhomes, and 20 residential cottage units, the Mirasol Homes development includes 247 single-family homes, 160 of which are located off-site and now provide affordable homeownership opportunities to low-income families. In order to serve the greatest number of families possible, with limited HOPE VI resources, SAHA worked with the architects and developers to value-engineer all aspects of the homes. Part of that process required judgments to be made as to the grade and quality of the construction materials. SAHA recognizes that there can always be debate about whether a particular material selection was “the best decision;” however, the choices were made to deliver the most affordably priced home, and to pass those savings on to the families. All decisions met City of San Antonio building codes, and were consistent with similarly priced homes throughout the city. In the end, the 3-, 4- and 5-bedroom homes, ranging in living space of 1,200 to 1,700 square feet, are being offered and purchased by low-income qualified families for a very affordable average price of \$73,500.

Finding: SAHA unnecessarily spent over \$1.8 million due to plans to build on the landfill, to include \$1,037,000 to extend the project manager's contract; \$340,255 for designing buildings on the landfill; \$243,976 to fence in and test stockpiled soil; \$207,574 to MJVT in a delay claim; and \$33,047 for rezoning and replatting expenses.

SAHA Response: SAHA concurs with this finding, which is consistent with SAHA's own internal investigation completed in late 2002.

As published on December 19, 2002, SAHA's review stated:

In 1994, then President and CEO Apolonio Flores, in conjunction with SAHA's Architectural, Engineering and Construction Services (AECS) department, then headed by Frank Jasso, engaged the architectural firm of Davis-Durand Hollis and Rupe (DDHR) to develop a master plan for the Mirasol development as part of HOPE VI Grant activities. Heading the HOPE VI Grant efforts for SAHA's AECS was Ramiro Maldonado.

In early 1995, AECS received from DDHR a drafted Mirasol master plan, along with a preliminary geotechnical exploration report for the Mirasol area, dated January 10, 1995. The report, prepared by ATSER, LLC, included a cover letter, in which ATSER advised DDHR that "additional borings are recommended in order to better define the subsurface stratigraphy prior to development of the final construction drawings." This recommendation for additional test borings was based on the results of test borings #3 and #4 which identify fill material, such as wires, shoes, debris, etc.

In 2003, a further search of SAHA files revealed a December 1994/January 1995 document, in which SAHA's Maldonado informed his superiors, Jasso and Flores, of the preliminary geotechnical report. Notes on the document indicate that both Flores and Jasso considered the possibility that a former landfill existed on the Mirasol property, but there is no documentation to indicate that any action was taken to notify any other staff, board members or other officials of the concern. Instead, the master plan work proceeded, without communicating the need for further necessary environmental impact tests to determine the extent of the fill area and any contamination, until the preliminary geotechnical report was reviewed in January 1999, as described below.

The SAHA 2002 report went on to explain that:

In January 1997, (two years after the preliminary geotechnical report) the SAHA Board of Commissioners appointed Melvin Braziel to serve as the acting President and CEO of SAHA, following the termination of Apolonio Flores. Within weeks of his appointment, the Office of the Inspector General (OIG) came to SAHA as part of a nationwide audit of HOPE VI programs. The OIG questioned SAHA about the HOPE VI progress delays. In response to the inquiries from the OIG, SAHA, now led by Braziel, created the Investment Initiatives Department, to be responsible for the implementation of both HOPE VI programs at Mirasol and Springview, and named Diana Kinlaw to head the new department. Then on January 7, 1999, Heery International, Inc., led by Jim

Piekarski, was chosen project manager for Mirasol. In early 1999, during the development of construction documents for the Mirasol townhomes, DDHR's structural engineer reviewed the ATSER geotechnical report and the 1995 cover letter. The review revealed that only five preliminary test borings had been completed and that there was a presence of fill material at the Mirasol site in the area that has since become known as Parcel B. In response, the DDHR engineer requested an additional 29 test borings in Parcel B, and SAHA's Maldonado ordered the borings. After completion of the 29 borings, Nova Consulting Group submitted their findings on July 20, 1999, identifying the detailed footprint of the undocumented fill area and recommending that SAHA contact the Texas Natural Resource Conservation Commission (TNRCC) for further study, which was done.

At present, there are nine monitoring wells on the site. The TNRCC has determined that the drinking water to the developed areas of Mirasol is safe, and there is no health risk to those living in the area. SAHA is working in close cooperation with our environmental consultant, Geomarine, Inc., and the Texas Commission on Environmental Quality (TCEQ, formerly TNRCC). SAHA has enough money remaining in its HOPE VI budget to design and implement a cap for Parcel B, and will develop the land into a park to serve the recreational needs of the community.

SAHA's 2002 report included the following environmental impact summary information:

In the time leading up to the July 1999 environmental report, the Mirasol development had been moving forward, (despite the 1995 preliminary geotechnical exploration report). The master plan was already drawn, the buildings were in construction documents, and SAHA was getting ready to go out for Developer/Contractor bids. The devastating results of (not responding to the environmental findings in 1995) required significant redesign of the master plan, including the moving of some buildings off the Parcel B site and the elimination of other structures altogether. If the impact study had been done at that time (1995-1997), many of the Mirasol-related hardships, delays and expenses would have been avoided. The financial impact of these events led to the unanticipated expenditure of more than \$2 million to-date.

While SAHA acknowledges the inexcusable lack of action in response to early indications of an environmental concern on Mirasol's Parcel B, SAHA disagrees with the OIG labeling of the \$1,861,852 as ineligible payments. Upon the discovery by other SAHA officials of the environmental condition in 1999, SAHA and HUD had only two options: to abandon the project and walk away from the community; or to take the necessary action to move the project forward to provide the community with the much needed housing for low-income families. All parties involved decided to serve the community by moving the project forward. The environmental impact was monitored, the master plan was revised to relocate buildings, contracts were extended and apartments and homes were ultimately built. Even in hindsight, SAHA strongly believes this was the right thing to do.

Finding: SAHA cannot support payroll expenses for Springview and Mirasol. SAHA is unable to locate supporting documentation. OMB Circular A-87 states that in order for costs to be allowable, they must be adequately documented. Based on projecting the error rate to the universe, we estimate SAHA cannot support about \$1,922,633. SAHA needs to provide adequate support to HUD for all of its payroll expenses or repay the HOPE VI grants \$1,922,633 from non-Federal funds.

SAHA Response: SAHA disagrees with this audit finding for various reasons.

The audit occurred during a peak work period at SAHA. Finance and accounting personnel were simultaneously working on the OIG Audit, the annual external audit, an FDS data submission, and year-end payroll reporting. The audit covered a 10-year period and SAHA personnel attempted to provide all requested documentation. The payroll data was the last portion of the audit and unfortunately, due to time constraints, SAHA was unable to provide all requested data prior to the day the auditors completed the field work.

First, due to time constraints, the auditor was not able to consider certain SAHA documentation that support the questioned payroll costs. Second, the sampling process may not have been representative of the population of payroll records, so it would be difficult to draw conclusions from the sample. Third, the projection of an error rate may have included individually significant items that should not be projected to the population when using accepted audit procedures.

The auditors concluded that SAHA could not support certain payroll costs; however, after the completion of fieldwork, SAHA personnel have located additional payroll documentation and feels that all payroll costs under audit were proper. Moreover, SAHA's independent auditors previously audited these accounts and were satisfied with SAHA documentation.

The OIG auditor conclusion is partially based on their search of SAHA's files for a special type of antiquated payroll allocation document that does not exist and is not required by HUD regulations. Years ago, SAHA took steps to improve its payroll processes by eliminating unnecessary paperwork and simplifying time reporting. At that time, SAHA salaried employees who were solely dedicated to one project, began reporting only non-standard items or "exceptions" on their time sheets. Standard items, such as the location or project where the work occurred were not reported, in accordance with practices in place at the time.

During the audit, complete documentation that supports the payroll costs was not available. We have subsequently been able to locate additional documentation. Attached is a worksheet showing the items questioned in the audit sample along with our comments, conclusions, and additional information that the auditor was not able to consider. The worksheet summary indicates that the vast majority of questioned items are properly supported and documented by SAHA. While the auditors questioned \$78,819 in payroll costs, we are able to provide support and documentation for these questioned costs.

One example of questioned costs is the payroll cost of Ray Doyle who worked exclusively on HOPE VI. Mr. Doyle's time was devoted entirely to HOPE VI and he never worked on other

projects. We have subsequently been able to locate Mr. Doyle's timesheets and SAHA's budget records indicate that he was assigned to HOPE VI. We are also able to provide payroll records, a job description, and various HOPE VI documents bearing his signature as further evidence of his assignment. If necessary, SAHA personnel will also provide an affidavit stating that Mr. Doyle worked exclusively on the HOPE VI projects.

The auditors also questioned a payroll item that we have now determined is not related to HOPE VI. The item was not in the audit scope and should be removed from the audit sample.

SAHA took a conservative approach to charging payroll costs to the HOPE VI projects, absorbing many significant costs that were related to and directly attributable to the project. In November 1999, during a nationwide OIG review of the HOPE VI projects, SAHA reviewed the accounting records and eliminated the allocation of all employees working less than 25% on the project. Although these costs could have been charged to HOPE VI, they were absorbed by SAHA. As an example, various accounting personnel worked on tracking the large complex projects, however, SAHA only charged 25% of the cost of one accountant to HOPE VI and absorbed the remaining costs related to the other personnel. The OIG auditor may not have taken these additional costs into consideration.

Secondly, the sampling process may not have been representative of the population. The monetary unit sample method, a relatively new technique, was used. A properly selected audit sample should seek to represent the population from which it was drawn, however, the monetary unit method selects records according to value.

The larger the sample, the more closely it depicts the population; however, the monetary unit sample method tends to focus on a smaller sample size and has a bias toward large but infrequent errors. The higher payroll amounts were much less frequent, had a low error rate, but had a higher possibility of being selected in the sample. Some audit situations may require a large audit sample to assure that the sample represents the universe, and we believe this might be the case with the review of payroll costs.

And thirdly, the projection of the error rate included individually significant items that should not be projected to the population when using accepted audit procedures because the result of testing of individually significant items is not considered sampling. In other words, audit procedures normally require removal of individually significant items prior to projecting the sample results to a population. It is our belief that this was not done with the payroll sample.

It is our conclusion that the audit finding that \$1,922,633, or 46%, of payroll costs cannot be supported is incorrect because, due to their short deadlines, the auditors were unable to review all available support documentation; and the sampling and projection technique used may not have been appropriate.

Finding: *SAHA limited competition on the Mirasol Development Contract.*

SAHA Response: SAHA disagrees that competition was limited in violation of any procurement laws or requirements.

Firstly, paragraph 3 on page 9 makes unsubstantiated assumptions that are wholly unrelated to the facts and scope of this audit, and should therefore be deleted. That this successful bidder may have shown an earlier interest in performing work for SAHA is usual and customary in this industry. Many vendors bid on multiple SAHA contracts before receiving work from the agency.

With regard to the required bidder qualifications, prior to the issuance of the Request for Qualifications (RFQ) for Design-Build Developer/Contractor Services, the OIG had urged SAHA to quicken its pace of development at Mirasol. In order to accomplish this, SAHA needed to procure a builder with the financial and organizational resources to produce 247 single-family homes in a short amount of time. Additionally, SAHA recognized the need for a builder with the financial capability to stand behind the warranties on the homes. While SAHA acknowledges that this requirement to demonstrate a strong financial capacity may have led to the decision on the part of some builders to not respond to the RFQ, it did not violate any procurement laws. Furthermore, it was not SAHA's intent to discourage bidder participation, but rather to protect the HOPE VI grant resources. SAHA agrees that the Mirasol Joint Venture Team (MJVT) created a competitive advantage for themselves through KB Home's offer and ability to construct the homes and forego any progress payments until SAHA agreed that the homes were substantially complete. Given the time constraints, the large quantity of homes to be produced and the significant financial resources needed to accomplish this task, the financial requirements were sound and well within procurement policies. As this may have served as a deterrent to other bidders is simply the nature of a complex competitive project, such as this. SAHA remains convinced that, given the circumstances, it was a necessary and responsible requirement.

Finding: *SAHA did not adhere to contract terms by paying MJVT \$10,612 in excess overhead and profit related to change orders*

SAHA Response: SAHA is still researching this item.

If SAHA records verify the conclusion reached by the OIG, SAHA will seek repayment of these funds by MJVT.

Finding: *SAHA used (\$4,581 in) HOPE VI funds to pay expenses of other projects.*

SAHA Response: SAHA disagrees with this finding.

The \$4,581 in legal fees was incurred relative to SAHA's attempt to utilize HOPE VI grant funds to increase the number of replacement units available to Mirasol residents. The Mirasol development was intended to be a mixed-financed community, incorporating HOPE VI grant funds with the proceeds from the sale of tax credits as the primary sources of development funds. The expenditure cited by OIG related to discussions with counsel regarding applications SAHA submitted for a 4% volume cap bonds allocation. If awarded, that allocation of volume cap bonds would also provide 4% tax credits from which SAHA could raise the additional capital needed to convert the Christ the King development to public housing as Mirasol replacement units. That this application was unsuccessful does not make the payment for the services ineligible.