

## AUDIT REPORT

CITY AUDITOR

<b>Report Date:</b>	<b>February 23, 2017</b>
<b>Department:</b>	<b>Community Services/Housing &amp; Community Development Division</b>
<b>Subject:</b>	<b>Housing Rehabilitation Program</b>
<b>Lead Auditor:</b>	<b>Karen Newman</b>

### **OBJECTIVE**

This audit was conducted to determine whether adequate controls are in place to ensure compliance with Housing Rehabilitation Program requirements for eligibility, procurement, and expenditures.

### **SCOPE & METHODOLOGY**

The audit scope included Homeowners Rehabilitation projects (under the Housing Rehabilitation Program) completed in fiscal years 2014 through 2016. To meet our objective, we interviewed staff members, reviewed Housing and Community Development policies and procedures, reviewed project documentation, and performed other tests and procedures as necessary.

### **BACKGROUND**

The City of Mesa's Housing Rehabilitation Program is administered by the Housing and Community Development Division of the Community Services Department. It is funded by the Community Development Block Grant (CDBG) awarded to the City by the U.S. Department of Housing and Urban Development (HUD). In FY 2016, the City was awarded a total of \$3.2M in CDBG funding. Of that amount, the City Council allocated \$1.25M for housing rehabilitation activities, of which \$650,000 was used specifically on the Homeowner's Rehabilitation Program for eligible owner-occupied homes.

Each fiscal year, the City adopts an Administrative Plan for the Homeowners Rehabilitation Program. This document outlines the specific requirements for participation in the program, contractor selection and performance, and procedures for placing loans/liens on the properties. The Plan is designed to ensure compliance with federal guidelines, while meeting the goals of the program, which include:

- Eliminate health and safety hazards in homes
- Benefit low-income, very low-income, extremely low-income, and disabled residents
- Improve neighborhoods and encourage long-term stability
- Address energy efficiency issues

### **CONCLUSION**

In our opinion, internal controls are in place and operating effectively to provide reasonable assurance that Homeowners Rehabilitation projects are conducted in accordance with the majority of applicable requirements. However, improved controls are needed to ensure that exceptions to program requirements are adequately approved and documented, and that project change orders are signed by the homeowner before work proceeds. A summary of our observations and

recommendations is included below. For additional details and responses from management, please see the attached Issue and Action Plans (IAPs).

**OBSERVATIONS & RECOMMENDATIONS:**

1. **Observation:** Exceptions to program requirements are not always documented as required by the Administrative Plan. The Plan allows for exceptions when warranted, but expressly states that exceptions must be documented and approved by the Rehab Committee. We found exceptions granted in all areas of the program (i.e. eligible participants, properties, expenses, contracting, liens); however, the project files contained no documentation for the exceptions.

**Recommendation:** Exceptions to program requirements should be documented and approved by the Rehab Committee. Additionally, the "Housing Rehabilitation Program Checklist" should include a step to ensure that the project file includes documentation for exceptions granted.

2. **Observation:** Project change orders were not signed by the homeowner and/or contractor before work proceeded as required by the Administrative Plan. Even though the homeowner is not required to pay for change orders, and Housing Services now records change order amounts as grants instead of liens, the homeowner must approve of any work to be done before the contractor proceeds.

**Recommendation:** Required signatures should be obtained for all change orders before work proceeds.

## Issue and Action Plan

### **Issue #1: Exceptions to Program Requirements Not Documented**

**Observation:** Exceptions to program requirements are not always documented in the project files, as required by the Administrative Plan.

**Criteria:** The Administrative Plans for FY13/14 and FY14/15 state:  
*"In cases of particular need and/or special extenuating circumstances, the Loan Review Committee may grant exceptions to any of these rules. In case an exception is granted, a "Memo to the File" stating why the exception was warranted will be placed in the project file."*

The Administrative Plan for FY15/16 states:  
*"In cases of particular need and/or special extenuating circumstances, the Rehab Committee may grant exceptions to any of the guidelines and rules stated in the Housing Rehabilitation Administration Plan. In case an exception is granted, a memo to the file stating why the exception was warranted will be placed in the project file."*

**Comments:** To ensure compliance with federal regulations, the Homeowners Rehabilitation Program Administrative Plan contains specific language regarding participant, property, and expense eligibility; loan/lien filings; and contracting requirements. When exceptions are warranted, documentation regarding the reason for the exception, along with proper approval, should be included in the project file. When testing for compliance with program requirements, we found that the following exceptions were made, but were not documented as required:

- 4 exceptions to the requirement that a manufactured home must be built before June 15, 1976.
- 2 exceptions to the requirement that mortgage payments must be current.
- 4 exceptions to the requirement that "the Major Rehab Program will allow up to \$50,000 of repairs to qualifying homes of low-income homeowners."
- 1 exception to the requirement that "Homeowners who have previously participated in the program cannot participate again as long as there are other applicants on the waiting list, and/or if the original lien has not been forgiven."
- 1 exception to the requirement that "All change orders over \$1,500 (Sub-contractor's price) will require three bids."
- 4 exceptions to the requirement that "The contract will be for sixty (60) working days. The contractor may request in writing, an

extension for extenuating circumstances beyond the contractor's control. The Housing Supervisor will deny or grant in writing, an extension for a sufficient amount of time to complete the performance."

- 1 lien exception on an NSP home purchase rehab.
- Lien exceptions for all Emergency Repair Program projects – a policy change was made to process these as grants instead of liens, but the Plan was not amended to reflect this change, and the exception was not documented in the project files.

**Recommendation:** Housing Services should implement more effective internal controls to ensure that exceptions to program requirements are documented in the project files. For example, the "Housing Rehabilitation Program Checklist" should be revised to include a step to ensure all exceptions are documented as required.

**Management  
Response:**

**Action Plan #1:**

More effective internal controls have already been implemented as demonstrated on the updated Housing Rehabilitation Program Checklist, which is attached. Please see attached checklist for reference.

**Individual or Position Responsible:** Housing Rehab Specialist and Supervisor

**Estimated Completion Date:** January 2017

## **Issue and Action Plan**

### **Issue #2: Required Signatures Not Obtained for Change Orders**

<b>Observation:</b>	Project change orders were not signed by the homeowner and/or contractor prior to work proceeding.
<b>Criteria:</b>	<p>The Administrative Plans for FY13/14, FY14/15, &amp; FY15/16 state:</p> <p><i>"The Homeowner must be informed of any changes to the contract or other problems encountered during the rehabilitation work, and sign the Change Order form before work proceeds."</i></p> <p>The Administrative Plan for FY15/16 states:</p> <p><i>"The contractor will sign the Change Order, have the homeowner sign the Change Order, and return it to the HCD Rehab office before proceeding with any work."</i></p>
<b>Comments:</b>	<p>These requirements are intended to prevent unauthorized change orders and unnecessary program expenses, which could preclude other homeowners on the waiting list from receiving necessary repairs.</p> <p>30 of 33 change orders reviewed did not have required signatures.</p>
<b>Recommendation:</b>	Required signatures should be obtained for all change orders before work proceeds. Or, if appropriate, management should re-evaluate the change order process and related risks, and update the Administrative Plan to reflect current practices.
<b>Management Response:</b>	<p><b>Action Plan #2:</b></p> <p>The Administrative Plan was updated July 1, 2016 to state change order approval from the homeowner is required before work proceeds. Please see attached page 20 from the Administrative Plan with this requirement. Also attached is the Change Order form with a signature line for the homeowner's authorization.</p> <p>The following new protocol ensures that internal controls are put in place to effectively utilize these tools.</p>

### **Change Orders**

Coordination of all Change Orders will be handled by the Housing Rehab Specialist for all projects.

Prior to any work being performed, all Change Orders will be submitted to the Housing Rehab Specialist.

The Housing Rehab Specialist will ensure:

1. The requirements for submission have been met.
2. If not already performed, a site inspection will be performed to verify the necessity of the Change Order.
3. The proper documentation will be attached (including the site inspection verification).
4. City approval (budget & scope) must be approved by: a). the Inspector; b). the Housing Rehab Specialist; and c). Program Supervisor.
5. After the Program Supervisor has approved, the Homeowner must also approve.
6. After Step #5, the Housing Rehab Specialist will issue the Notice to Proceed (signed by the Housing Rehab Specialist and the Program Supervisor) on the Change Order with copies to the Homeowner.

Notes: Step #4 – The Inspector signature verifies the necessity & the scope/budget; the Housing Rehab Specialist signature verifies the project file, process and documentation are in place and that all steps are performed correctly; the Program Supervisor signature provides the Ok to proceed.

This protocol has two separate check & balances by the Housing Rehab Specialist & Program Supervisor ensuring system success.

**Individual or Position Responsible:** Housing Rehab Specialist and Supervisor

**Estimated Completion Date:** November 2016

# HOUSING REHABILITATION PROGRAM CHECKLIST

PLACE ITEMS IN FILE FROM LEFT TO RIGHT

HOMEOWNER: \_\_\_\_\_ ADDRESS: \_\_\_\_\_  
DATE APPROVED TO PROCEED: \_\_\_\_\_ FILE CASE NUMBER: \_\_\_\_\_

## SECTION I

_____ *Environmental Report	_____ *Rehab Committee Approval	_____ *SHPO
_____ *SAM (System for Award Management) Run same day contract is signed	_____ Final Sub-Contractor List	_____ Proposed Project Schedule
_____ Correspondence, Notes, Etc.	_____ *Contact Sheet	_____ Other

## SECTION II

_____ *Application	_____ *Verification of Ownership Deed/Title <input checked="" type="checkbox"/> Real Quest	_____ Year House was Built
_____ *Recent Mortgage Statement	_____ *Homeowners Insurance	_____ *Claims Against HO Insurance Yes _____ No _____
_____ *Latest Power Bill	_____ *Lot Rental Agreement Mobile or Manufactured Home	_____ CCR'S Home Owner's Association
_____ * Photo Identification	_____ * Verification of Income	_____ * Recent Two Yrs. Tax Returns
_____ * Two Months Bank Statements	_____ * HUD Income Determination (From all sources)	_____ * Legal Residency Statement or Transcripts
_____ * Privacy Notice	_____ * Memo of Understanding	_____ Receipt of Lead Hazards Notice Signed by Homeowner

## SECTION III

_____ *Contractor's Quotation Specifications Included	_____ *Homeowner has Approved Quotation and Specifications	_____ *Office Estimate Full Rehabilitation Only
_____ *Contractor Selection If chosen from rotating list, print current list	_____ *Invitation to Bid Full Rehabilitation Only	_____ *Pre-Bid Sign-in Sheet Full Rehabilitation Only
_____ Bid Abstract Full Rehabilitation Only	_____ *Bidder is an LLC - Affidavit	_____ NOTICE TO PROCEED

## SECTION IV

_____ Financial Summary Sheet	_____ *Contract	_____ Change Orders
_____ Lien Waivers	_____ Invoices and Payments	_____ Warranties

## SECTION V - FULL REHABILITATIONS ONLY

_____ *Opportunity to Rescind	_____ *Deferred Payment Agreement (5YR or 10YR)	_____ *Deed DPL
_____ *Deed Perm	_____ Permeant Lien Promissory Note	_____ Payment Agreement/Conditions

## SECTION VI

_____ Building Permit	_____ Pest Inspection Certification	_____ Pest Treatment Report
_____ Inspection Log Signed by Inspector	_____ Punchlist	_____ Certificate of Release
_____ MBE/WBE (HUD)	_____ Sec.3 (HUD)	_____ Other

Notation to File:

- 
- 

**\*MUST BE IN FILE PRIOR TO "NOTICE TO PROCEED."**

File Closed and By: \_\_\_\_\_

Date: \_\_\_\_\_

File Audited By: \_\_\_\_\_

Date: \_\_\_\_\_

Per HUD regulations 24 CFR85.36 (h), any contract that exceeds the simplified acquisition threshold, (currently set at \$150,000) will require any bidder and/or contractor to provide: (1) a bid guarantee from each bidder equivalent to ten percent of the bid price, (2) a performance bond on the part of the contractor for 100 percent of the contract price, and (3) a payment bond on the part of the contractor for 100 percent of the contract price.

### **Change Orders**

Change Orders may be requested by the contractor for items that were not included in the original work write-up, due to unforeseen health, safety, or code violations. The contractor must have an approved Change Order from the Housing Rehabilitation Coordinator. The contractor will sign the Change Order, have the homeowner sign the Change Order, and return it to the HCD Rehab office before proceeding with any work. In the HCD Coordinator's absence, a designee or a member of the Rehab Committee may approve the Change Order.

The homeowner must be informed of any changes to the contract or other problems encountered during the rehabilitation work, and sign the Change Order form before work proceeds. All Change Orders over \$1,500 (sub-contractor's price) will require three bids.

If for any reason changes are approved during construction at no additional cost, a zero Change Order must be completed following the same procedure as established for a regular Change Order.

### **Section 3 and MBE/WBE Contractors Participation**

The contractor and all sub-contractors shall comply with Section 3 of the HUD Act of 1968, which requires that, to the greatest extent feasible, economic opportunities must be created for low- and very-low-income persons and Section 3 businesses. This will be done by targeting low-income areas, public-housing residents, homeless shelters, placing ads in minority

**CDBG Homeowner Rehabilitation Program**

**Change Order #** \_\_\_\_\_

**CLIENT:** \_\_\_\_\_ **PROJECT #:** \_\_\_\_\_

**WORK DESCRIPTION:** \_\_\_\_\_  
\_\_\_\_\_

**REASON:** \_\_\_\_\_

**COST:**

<b>SUB CONTRACTOR PROPOSAL</b>	_____
10% Overhead	<u>\$0.00</u>
15% Profit	<u>\$0.00</u>
<b>SUBTOTAL</b>	<u>\$0.00</u>
<b>SALES TAX (5.2325%)</b>	_____
<b>TOTAL:</b>	<u>\$0.00</u>

<b>CONTRACTOR PROPOSAL</b>	_____
<b>SALES TAX (5.2325%)</b>	_____
<b>TOTAL:</b>	<u>\$0.00</u>

Any person who knowingly makes a false statement or a misrepresentation in the use of funds for the purpose of Federal Financial Assistance, or causes a false statement or misrepresentation to be made, shall be subject to a fine of not more than \$5,000 or by imprisonment for not more than two years, or both, under provisions of the U.S. Criminal Code.

**VERIFICATION:**

**Homeowner:** \_\_\_\_\_ **Date:** \_\_\_\_\_

**Contractor:** \_\_\_\_\_ **Date:** \_\_\_\_\_

**Approved:** X \_\_\_\_\_ **Date:** \_\_\_\_\_

**OFFICE USE ONLY:**

<b>CONTRACT PRICE:</b>	<u>\$0.00</u>
<b>APPROVED C.O.'S:</b>	<u>\$0.00</u>
<b>SUB TOTAL:</b>	<u>\$0.00</u>
<b>THIS CHANGE ORDER:</b>	<u>\$0.00</u>
<b>TOTAL:</b>	<u>\$0.00</u>