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TO: Olga I. Sáez, Director, Public and Indian Housing, San Juan Field Office, 4NPH

//signed//
FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: The Puerto Rico Public Housing Administration, San Juan, Puerto Rico, Mismanaged Its Capital Fund Financing Program and Inappropriately Obligated $32 Million in Recovery Act Funds

HIGHLIGHTS

What We Audited and Why

We audited the Puerto Rico Public Housing Administration's (authority) Capital Fund Financing Program (Financing Program) as part of the Office of Inspector General's (OIG) strategic plan goals to improve the U.S. Department of Housing and Urban Development's (HUD) fiscal accountability. We selected the authority based on the size of its Financing Program. Our audit objectives were to determine whether the authority obligated and expended the 2003 Financing Program funds in accordance with HUD requirements, the authority's financial management system complied with program requirements, the authority completed the proposed modernization activities under its 2003 Financing Program, and the authority had the capacity to administer additional funds under the American Recovery and Reinvestment Act (Recovery Act) of 2009.

What We Found

The authority did not manage the 2003 Financing Program in an economical, efficient, and effective manner. It did not complete all of the proposed rehabilitation activities and did not expend all of the borrowed private capital. As

a result, it did not meet its rehabilitation goals. In addition, the authority disbursed more than $57.4 million in capital funds to pay for interest charges on unused borrowed capital that did not provide the intended benefits to the public housing program or its residents.

The authority also could not account for more than $18.7 million in program income and did not use $50.3 million in program income to defray program costs. In addition, it did not maintain accurate and current accounting records and provided HUD inaccurate information on its Financing Program activities. As a result, its internal controls were not sufficient to safeguard assets or ensure that funds were used in accordance with applicable requirements, and HUD lacked assurance regarding program accomplishments.

The authority inappropriately obligated $32.12 million in Recovery Act funds to supplant expenditures from other nonfederal funds in violation of its annual contributions contract with HUD. This deficiency occurred because the authority substituted the obligations related to nonfederal funds with Recovery Act funds. As a result, the authority will use Recovery Act funds to pay for expenditures that were the responsibility of nonfederal sources.

What We Recommend

We recommend that the Director of the San Juan Office of Public Housing require the authority to reimburse more than $57.4 million in unallocable and ineligible Financing Program expenses, account for more than $18.7 million in unrecorded program income, and develop and implement an action plan to use $50.3 million in program income to defray program costs. We also recommend that the authority establish better controls to ensure that the Financing Program has (1) a financial management system that complies with HUD requirements and (2) procedures to ensure that program goals are achieved in a timely and efficient manner and avoid unreasonable/unnecessary expenses. In addition, we recommend that the Director require the authority to properly account for its 2003 Financing Program receipts and disbursements.

The Director should also require the authority to deobligate more than $31 million in Recovery Act funds that were contracted before the authorized obligation start date and implement adequate procedures and controls to ensure that Recovery Act funds are used effectively, efficiently, and in accordance with applicable requirements.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the findings with authority and HUD officials during the audit. We provided a copy of the draft report to the authority on August 21, 2009, for its comments and discussed the report with authority officials at the exit conference on September 10, 2009. The authority provided written comments on September 15, 2009, and generally disagreed with our findings.

The authority's response, along with our evaluation of that response, can be found in appendix B of this report. Attachments to the authority's comments were not included in the report but are available for review upon request.

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BACKGROUND AND OBJECTIVES

The Puerto Rico Public Housing Administration (authority) is a governmental entity created by Commonwealth Law No. 66, dated August 17, 1989. The authority provides a full range of services related to the rehabilitation, operation, and maintenance of its public housing projects. It is the second largest public housing agency in the nation, with more than 56,000 dwelling units scattered throughout Puerto Rico. The authority's records are maintained at 606 Barbosa Avenue, San Juan, Puerto Rico.

The Capital Fund Financing Program (Financing Program) allows a housing agency to borrow private capital (through bonds or conventional bank loans) to make improvements to its housing developments. The U.S. Department of Housing and Urban Development (HUD) allows a housing agency to pledge a portion of its future annual capital funds to make debt service payments for the amount borrowed under the Financing Program. Housing agencies pursuing any type of Financing Program activities must follow all statutory and regulatory requirements related to the Public Housing Capital Fund program in regard to the development and implementation of their Financing Program proposal.

In December 2003, HUD approved the authority's Financing Program proposal to issue 2003 bonds with total proceeds of $693 million for the rehabilitation of more than 8,000 units in 44 public housing projects. The authority's deadline for obligating the 2003 bonds was December 2005, and the deadline for expending 100 percent of the bonds was December 2007.[1]

In October 2007, the authority informed HUD that it did not anticipate being able to fully expend the 2003 bond proceeds within the prescribed timeframe and requested an extension to the obligation deadline. The authority attributed the delay to the complexity and the multiple facets of the 2003 bond transaction. HUD approved a one-year extension on December 7, 2007, that extended the obligation deadline to December 2006 and the expenditure deadline to December 2008.

In June 2008, the authority submitted a proposal to HUD to use unexpended 2003 bond proceeds to pay off part of the existing debt, issue new bonds of approximately $380 million, and provide for a $235 million tax credit investment. HUD approved the proposal in June 2008. In August 2008, the unexpended 2003 bond proceeds were placed in escrow to redeem the bonds as they reached maturity.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (Recovery Act). The Recovery Act provided additional Public Housing Capital Fund program funds to public housing agencies across the country to create and preserve jobs and to help stabilize the economies of state and local governments. The Recovery Act imposes strict obligation and expenditure deadlines that housing agencies must meet to avoid strict recapture provisions. On March 18, 2009, HUD granted more than $174.5 million in

[1] Regulations at 24 CFR (*Code of Federal Regulations*) 905.120 provide that at least 90 percent of the funds must be obligated before the end of the second year and fully expended before the end of the fourth year after the funds become available.

capital funds authorized under the Recovery Act. As of July 2009, the authority was responsible for managing more than $1.3 billion in funding for modernization of its public housing projects.

Our audit objectives were to determine whether the authority obligated and expended the 2003 Financing Program funds in a timely manner as prescribed by regulations, the authority's financial management system complied with HUD requirements, the authority completed all of the proposed rehabilitation efforts, and the authority had the capacity to administer funds received under the Recovery Act.

RESULTS OF AUDIT

Finding 1: The Authority Mismanaged Its Financing Program

The authority did not manage the 2003 Financing Program in an economical, efficient, and effective manner. It did not complete all of the proposed rehabilitation activities and did not expend all of the borrowed private capital. These deficiencies occurred because the authority's management did not implement adequate controls to effectively plan and coordinate the execution of its Financing Program activities. As a result, the authority did not meet its rehabilitation goals. In addition, it disbursed more than $57.4 million in capital funds to pay for interest charges on unused borrowed capital that did not provide the intended benefits to the public housing program or its residents.

Incomplete Modernization Efforts

In December 2003, HUD approved the authority's Financing Program proposal to issue more than $693 million in bonds for the rehabilitation of more than 8,000 units at 44 public housing projects. The authority's deadline for obligating the 2003 bonds was December 2005, and the deadline for completing the rehabilitation work and expending 100 percent of the bond proceeds was December 2007. In October 2007, the authority informed HUD that it did not anticipate being able to fully expend the 2003 bond proceeds as required by section 9(j)(5) of the United States Housing Act of 1937 and requested a one-year extension of the obligation deadline for reasons allowed under section 9(j)(2). The authority's reasons included multiple demanding issues in managing its large portfolio, complex and multiple facets involving a number of parties, and relocation of more than 350 families. On December 7, 2007, HUD granted a one-year extension to the obligation/expenditure date based upon the authority's request and a review of relevant information. Thus, the obligation deadline was extended to December 2006, and the expenditure deadline was extended to December 2008.

The authority had previously informed HUD that it obligated 100 percent of the funds in November 2005 and thus had met the obligation deadline. Therefore, the October 2007 extension request was not justified. Further, we asked the authority to identify the number of units that were completely rehabilitated between the date of the HUD approval letter and the revised expenditure deadline of December 2008. The authority stated that the information was not readily available, and it would need to review project files month by month to extract the information. Thus, the authority lacked information to demonstrate whether the extension resulted in a significant increase in rehabilitated units.

On March 12, 2009, the authority provided us with a summary schedule showing the status of the rehabilitation work associated with the 2003 bonds. The schedule showed that of the 44 proposed projects, 16 had been completed, 18 were in process, and 10 had not been funded. Of the 8,256 units that the authority had planned to rehabilitate with the 2003 bonds, only 3,606 had been completed. Thus, the authority did not complete the rehabilitation work in about 56 percent of the proposed dwelling units (see appendix C). Therefore, it did not fulfill its rehabilitation objectives, and tenants were deprived of the intended benefits of the Financing Program.

Inadequate Planning and Coordination

Regulations at 24 CFR (*Code of Federal Regulations*) 968.125 provide that housing agencies shall undertake the modernization activities in a timely, efficient, and economical manner.

Authority management did not implement adequate controls and failed to provide timely and efficient administration of its 2003 Financing Program activities, resulting in delays in the rehabilitation of the public housing units. For example, at the Jardines de San Fernando housing project, the authority notified the contractor to commence the rehabilitation work, although the construction permits had expired and required environmental studies had not been performed. Because the authority had to correct these violations, the rehabilitation work at the housing project was postponed.

Rehabilitation efforts at Jardines de San Fernando were not completed.

The rehabilitation contract for Jardines de San Fernando was awarded on May 3, 2005, with a completion date of July 10, 2008, which was beyond the December

2007 expenditure deadline date. According to the authority, about 41 percent of the rehabilitation work had been completed as of March 2009. Our site visit on April 23, 2009, confirmed that the rehabilitation efforts were still in progress. The new target completion date for the rehabilitation work is September 2010.

The Jardines de Montellanos housing project also had delays in its rehabilitation efforts. Although the contract was awarded on November 28, 2006, the authority did not notify the contractor to commence the rehabilitation work until October 22, 2008. The authority informed us that the notice to proceed was not provided in a timely manner, because the authority's project design contract had expired, and the authority had to rebid the services before the rehabilitation work started.

The contractor's offices at Jardines de Montellanos were closed.

On April 23, 2009, we visited Jardines de Montellanos and found that the rehabilitation had not commenced. According to the authority, the contractor's offices at the site had been closed for more than a year, and the contractor refused to commence the rehabilitation, alleging an increase in construction costs. The contractor claimed that it could not complete the work at the quoted price and attributed the cost increase to the authority's untimely notification to proceed with the work. The authority was negotiating with the contractor for a new timetable to begin the rehabilitation efforts.

Other housing projects were experiencing delays in their rehabilitation efforts. According to the summary schedule prepared by the authority, the rehabilitation work at four construction sites was between 314 and 622 days behind schedule.

Housing project	Construction start date	Days behind schedule	Authority's comments
Catañito Gardens	Feb. 8, 2006	314	Project lacks required endorsements from state agencies.
Arístides Chavier	Aug. 1, 2005	379	Poor management by general contractor and subcontractor.
Los Mirtos	Dec. 15, 2004	619	Contractor lacks adequate administrative and planning strategies.
El Coral	Jan. 9, 2006	622	Buildings have structural deficiencies.

The authority did not take into consideration the Financing Program expenditure requirements when it executed rehabilitation contracts for 12 housing projects. When HUD approved the authority's 2003 bonds, the deadline for expending 100 percent of the funds was December 2007.[2] However, the authority awarded contracts that were beyond the expenditure deadline. The contracts had end dates that were between 205 and 921days after the expenditure deadline.

Housing project	Contract date	Contract end date	Number of days beyond expenditure deadline
Jardines de San Fernando	May 3, 2005	July 10, 2008	205
La Lorenzana	July 14, 2005	July 12, 2008	207
San Fernando	Aug. 2, 2004	Nov. 4, 2008	322
Jardines de Campo Rico	Oct. 27, 2005	Nov. 15, 2008	333
Las Violetas	Dec. 13, 2005	Dec. 12, 2008	360
Villa Del Rio	Dec. 13, 2005	Dec. 12, 2008	360
Jardines de Cupey	Dec. 15, 2005	Dec. 14, 2009	727
Trina Padilla de Sanz	Aug. 12, 2005	Feb. 5, 2010	780
Jardines de Montellanos	Nov. 28, 2006	Mar. 12, 2010	815
Catañito Gardens	Dec. 13, 2005	Mar. 17, 2010	820
Turabo Heights	Oct. 6, 2005	Apr. 28, 2010	862
Arístides Chavier	June 23, 2005	June 26, 2010	921

The above examples are not all-inclusive but show the authority's ineffective planning and poor coordination efforts regarding its Financing Program activities. The authority's management failed to ensure that Financing Program goals were properly achieved in a timely and efficient manner.

Interest Paid for Unused Funds

The authority decided to pursue a mixed-financing modernization plan for its public housing developments and submitted a proposal to HUD in June 2008. In conjunction with the mixed-financing plan, the authority submitted a proposal to use the unexpended 2003 bond proceeds to pay off part of the existing debt. HUD approved the proposal in June 2008.

[2] Regulations at 24 CFR 905.120 provide that at least 90 percent of the funds must be obligated before the end of the second year and fully expended before the end of the fourth year after the funds become available.

In August 2008, more than $407 million in unexpended 2003 bond proceeds was placed in escrow with the authority's bond trustee to redeem the bonds as they reached maturity. We estimate that of the $102 million in capital funds used to pay for interest charges,[3] more than $57.4 million was associated with the unexpended 2003 bond proceeds. The authority used capital funds to make debt service payments for borrowed funds that were not used. Regulations at 2 CFR Part 225 provide that a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received. Therefore, the $57.4 million in interest charges was not an allocable expense since the unexpended funds did not benefit the authority's public housing program or its residents.

Conclusion

Because the authority did not implement adequate controls, it failed to manage the 2003 Financing Program activities in an economical, efficient, and effective manner. The authority did not complete all of the proposed rehabilitation activities and was unable to expend all of the borrowed private capital in a timely manner. It did not complete the rehabilitation efforts contained in the 2003 Financing Program proposal and used more than $57.4 million in capital funds to pay for interest expenses on unused borrowed capital that did not benefit the public housing developments or its residents. Management must address the weaknesses identified in this report to assure HUD that it can administer the Financing Program in an economical, efficient, and effective manner and achieve program goals.

Recommendations

We recommend that the Director of the Office of Public Housing

1A. Require the authority to reimburse the Public Housing Capital Fund program from nonfederal funds $57.4 million paid for the unallocable interest expenses.

1B. Require the authority to implement an adequate action plan to ensure that rehabilitation efforts and program goals are achieved in a timely, economical, efficient, and effective manner.

[3] The authority pledged a portion of its future annual capital funds to make debt service payments for the amount borrowed under the Financing Program.

Finding 2: The Authority's Financial Management System Did Not Fully Comply with HUD Requirements

The authority's financial management system did not account for more than $18.7 million in program income, and it did not contain accurate and current accounting records. In addition, the authority did not use $50.3 million in program income to defray program costs and provided HUD with inaccurate information on its Financing Program activities. These deficiencies occurred because the authority's management did not implement effective controls to ensure that the financial information on its Financing Program activities was complete and accurate. As a result, the authority's internal controls were not sufficient to safeguard assets and ensure their use in accordance with applicable requirements, and HUD lacked assurance regarding program accomplishments.

Unsupported Program Income

According to HUD officials, investment earnings on Financing Program funds are considered program income, and the receipts and expenditures of such income must be recorded as part of the financial transactions and subject to applicable requirements governing the use of Financing Program funds. The authority's accounting records did not show the disposition of more than $18.7 million in program income generated by the Financing Program.

The authority's records reflected that between December 2003 and September 2008, the Financing Program should have received more than $69.3 million in program income associated with interest earnings.[4] The general ledger showed that as of September 2008, the authority had disbursed $257,244 of the program income. Therefore, $69 million of the program income remained unexpended.[5]

We examined the Financing Program bank statements to verify that the unexpended funds remained deposited at the authority's financial institutions. Of the $69 million in unexpended program income, the bank statements reflected a balance of only $50.3 million as of September 2008. The authority's accounting records did not reflect the disposition of the remaining $18.7 million. An accounting official informed us that bank reconciliations were not performed on the investment accounts of the Financing Program.

The authority's fiscal controls were not sufficient to permit the proper tracing of program income at a level that would ensure that funds had not been used in violation of the applicable statutes. Although the authority informed HUD that more than $66 million in program income was available for future public housing

[4] The amount was determined from a summary schedule prepared by the authority's consultant and bank statements.
[5] In December 2008, the authority informed HUD that more than $66 million in unexpended program income was available for future public housing development activities and that the funds remained with the 2003 bond trustee.

development activities, bank statements reflected a significantly smaller amount of available funds, $50.3 million. At the time of our review, the authority was not aware of the unrecorded program income and did not provide support showing the location of the funds. It could not ensure that program income was adequately accounted for, safeguarded, and used for authorized and eligible purposes. The $18.7 million in unrecorded program income is unsupported pending an explanation and appropriate supporting documents showing the disposition and eligibility of the funds.

Inaccurate Accounting Records

The authority's annual contributions contract and 24 CFR Part 85 provide that housing agencies must maintain financial records that are accurate and current and that adequately identify the source and application of funds provided for assisted activities.

The authority's accounting records did not reflect current complete and accurate financial information on Financing Program activities. For example, transactions affecting the investment and revenue accounts had not been recorded since June 30, 2008. In addition, the accounting records did not include the transactions associated with the repayment of the 2003 bonds that took place in August 2008. The authority's accounting official attributed the delay in recording financial transactions to a lack of personnel and inadequate information from other authority officials. The accounting records also contained several instances of incorrect ending balances as a result of posting errors. For example, the interest income accounts contained more than $10 million in erroneous transactions.

In addition, the authority's accounting system did not reflect accurate information when obligations occurred. The dates recorded in the system represented the date the obligation was entered into the authority's accounting system and not the date when the contractual obligation occurred. The following table illustrates examples of the discrepancies in the obligation dates.

Contract number	Obligation date according to the accounting system	Contract date
2005-1070	Aug. 16, 2005	June 23, 2005
2005-0334	Sept. 2, 2004	Aug. 2, 2004
2006-0371	Nov. 29, 2005	Oct. 6, 2005
2006-0119	Sept. 20, 2005	Aug. 12, 2005
2006-0362	Dec. 13, 2005	Oct. 27, 2005

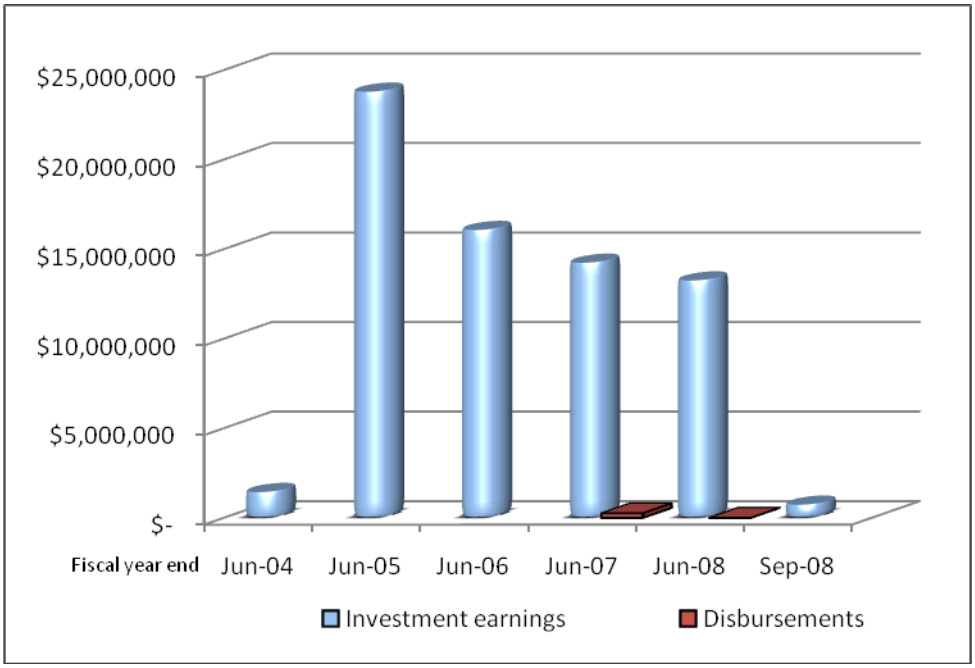
The authority's system did not permit the tracking of obligations by contract dates. Therefore, it was not adequate to monitor compliance with HUD's obligation requirements.

Unused Program Income

HUD's regulations at 24 CFR 85.25 state that grantees are encouraged to earn income to defray program costs.

The authority did not have a plan for the use of its program income, allowing the accumulation of a significant amount of cash in its investment accounts. As a result, it did not use the funds to defray program costs or benefit low-income housing projects and residents. Between December 2003 and September 2008, the 2003 bonds proceeds generated more than $69.3 million in program income. However, the authority's general ledger only reflected expenditures of $257,244, and the balance of its investment accounts remained consistently high during the same period. The 2003 bonds earned on average $11.5 million in program income per year.

Investment earnings and disbursements



The authority informed us that it did not have in place an action plan for the use of the investment earnings generated from the 2003 bonds. As a result, the balance of the program income continued to increase without benefiting the public housing program. Authority management must improve its controls over program income to ensure that the $50.3 million in unexpended funds is put to better use in accordance with HUD requirements.[6]

[6] The amount was determined from bank statements reflecting the accounts' cash balance as of September 2008.

Inaccurate Progress Reports

HUD's Financing Program guidelines provide that housing agencies must submit performance and evaluation reports reflecting the use of Financing Program proceeds. These reports are used to monitor program activities and ensure that the obligation and expenditure of the funds comply with HUD requirements. The authority's performance and evaluation reports were not accurate.

The performance and evaluation reports submitted to HUD reflected inaccurate information on the amount obligated. For example, the November 2005 report reflected that 100 percent of the 2003 Financing Program proceeds were obligated. However, the authority overstated the actual obligations by at least $14.9 million. From the $14.9 million in overstated obligations, $13.3 million was associated with unsupported budget estimates of expected expenditures associated with future relocation activities to be undertaken by the authority's managing agents. These budget estimates were not consistent with the definition of obligations as contained in 24 CFR 85.3. Accordingly, the authority did not follow HUD requirements and should not have reported the relocation activities as obligated funds. The remaining $1.6 million in overstated obligations was related to duplicate transactions, obligations not associated with the 2003 Financing Program, or obligations reported in excess of the contracted amount.

The authority also provided HUD with inaccurate information on the expenditures of its 2003 bond proceeds. The September 2008 performance and evaluation report reflected expenditures of more than $330 million. However, the authority's accounting records showed that a much higher amount was expended, more than $395 million. The performance and evaluation report for the period ending September 30, 2008, did not agree with amounts reflected in the authority's general ledger.

Account description	General ledger	Performance report	Difference
Fees and costs	$25,636,102	$22,483,369	$3,152,733
Site improvement	84,045,750	67,793,765	16,251,985
Dwelling structure	257,732,677	217,591,633	40,141,044
Nondwelling structure	14,490,778	12,020,158	2,470,620
Nondwelling equipment	43,536	0	43,536
Relocation cost	12,572,695	9,432,144	3,140,551
Development activities	1,319,928	873,378	446,550
Total	$395,841,466	$330,194,447	$65,647,019

An authority official informed us that the amounts included in the September 2008 performance and evaluation report were not verified or reconciled with the authority's accounting records. The amounts were obtained from the authority's

requisition reports.[7] Therefore, HUD had no basis for reliance on the reported information submitted by the authority.

Conclusion

The authority did not maintain a financial management system that adequately identified the source and application of Financing Program funds. Its accounting records were incomplete, since they did not reflect the complete and full history of all financial transactions. The noncompliance occurred because the authority's management did not implement effective controls to ensure that the financial information on its activities was complete and accurate. As a result, the authority could not ensure that program income was adequately accounted for, safeguarded, and used for authorized purposes and in accordance with HUD requirements. The authority must improve its internal controls to properly safeguard assets and improve the administration of its program income.

Recommendations

We recommend that the Director of the Office of Public Housing

2A. Require the authority to submit all supporting documentation showing the eligibility and propriety of more than $18.7 million in unrecorded program income or reimburse the Financing Program from nonfederal funds.

2B. Require the authority to develop and implement an action plan so that $50.3 million in unexpended program income is put to better use. At a minimum, the plan should include activities and target dates and ensure that such funds are used for the benefit of the public housing program and its residents.

2C. Take appropriate monitoring measures to ensure that the Financing Program has in place a financial management system that complies with HUD requirements. At a minimum, the system should ensure that fiscal controls and accounting procedures are sufficient to permit the tracing of funds at a level that ensures that such funds are not used in violation of the restrictions and prohibitions of applicable statutes.

2D. Require the authority to ensure that receipts and disbursements are properly accounted for and in compliance with HUD requirements and that revised performance and evaluation reports are submitted to HUD.

[7] The requisition reports are not the official accounting records. These are spreadsheets used by the authority to track advance requests made to the 2003 bond trustee.

Finding 3: The Authority's Recovery Act Funds Will Inappropriately Supplant Expenditures from Other Sources

The authority inappropriately obligated $32.12 million in Recovery Act funds to supplant expenditures from other nonfederal funds in violation of its annual contributions contract with HUD. This deficiency occurred because the authority substituted the obligations related to nonfederal funds with Recovery Act funds. As a result, the authority will use Recovery Act funds to pay for expenditures that were the responsibility of nonfederal sources.

Inappropriate Obligations

The authority's amendment to the annual contributions contract, section 7(j), provides that housing agencies must use Recovery Act funds to supplement and not supplant expenditures from other federal, state, or local sources or funds independently generated by the grantee. HUD Notice PIH [Public and Indian Housing] 2009-12(HA) authorized housing agencies to obligate Recovery Act funds starting March 18, 2009 (obligation start date). HUD's Recovery Act Web site clarified that any obligation recorded against the Recovery Act funds must be for new work not previously obligated and for activities that occur after the obligation start date.

In April 2009, the authority submitted its annual statement for the Recovery Act funds detailing the budget line items and the 39 projects that will benefit from the $174 million in capital fund recovery grants. The annual statement reflected more than $32.12 million obligated to five public housing developments as of March 31, 2009. We reviewed the obligations and related supporting documents to determine whether the obligations met HUD requirements. The $32.12 million in obligations was related to five rehabilitation contracts, totaling $46.18 million, awarded between October and November 2008.

Public housing project	Contract number	Nonfederal funds		Recovery Act funds supplanting nonfederal funds
		Obligation date	Obligated amount	
Narciso Varona	2009-541	Oct. 20, 2008	$9,879,114	$6,384,443
Manuel F. Rossy	2009-289	Oct. 22, 2008	10,316,000	6,493,889
Maximino Miranda	2009-595	Oct. 24, 2008	12,392,438	8,951,442
Ramirez de Arellano	2009-574	Oct. 31, 2008	4,040,000	2,543,167
La Alhambra	2009-619	Nov. 21, 2008	9,555,000	7,749,327
Total			$46,182,552	$32,122,268

The five contracts were previously obligated against other federal and local funds and awarded before the authorized obligation start date of March 18, 2009. Of the

$46.18 million in contracts awarded in 2008, $32.12 million was obligated against a line of credit with a governmental bank (local funds), and $14.06 million was obligated against various grants of the Public Housing Capital Fund program. In March 2009, the authority substituted the obligations related to the line of credit with Recovery Act funds. Therefore, the authority inappropriately obligated $32.12 million in Recovery Act funds to supplant expenditures from other local sources and for activities awarded before the authorized obligation start date. This substitution of Recovery Act funds for nonfederal funds will result in the authority using Recovery Act funds to pay for expenditures that were the responsibility of the nonfederal funds. Of the $32.12 million in inappropriate obligations, the authority disbursed more than $462,000 in June 2009. Therefore, the Recovery Act funds disbursements were ineligible.

An authority official informed us that Recovery Act funds were obligated for activities awarded before the obligation start date, because the authority believed that it was appropriate, and it had obtained HUD approval for this type of transaction. The authority did not provide support showing that HUD approved the use of Recovery Act funds to supplant expenditures from other sources. Further, this practice is in violation of the authority's annual contributions contract with HUD and inconsistent with requirements of the Recovery Act.

Authority management must improve its controls over its Recovery Act funds to ensure that they are properly obligated and that $31.65 million in inappropriate obligations is put to better use in accordance with HUD requirements.

Insufficient Capacity

The authority did not implement effective controls over its Financing Program and the activities funded under the Recovery Act to ensure compliance with all applicable regulations. As described in findings 1 and 2, the authority mismanaged its Financing Program, and its financial management system did not fully comply with HUD requirements. In addition, the authority obligated Recovery Act funds for activities that occurred before the authorized obligation start date in violation of its annual contributions contract with HUD.

The significant amount of funds under the authority's management, the restrictive program deadlines, and the authority's inefficient use of its 2003 Financing Program (see finding 1) raise concerns regarding the authority's capacity to administer the additional Recovery Act funds.

The authority currently administers more than $1.3 billion for rehabilitation of its public housing projects. Between fiscal years 2005 and 2008, the authority received more than $559.8 million in capital funds. In June 2008, it issued $386 million in bonds under the Financing Program and received an additional $235

million in tax credit investments. In March 2009, pursuant to the Recovery Act, the authority received an additional $174 million in capital funds. The program deadlines for these funds are near the deadlines for the Recovery Act funds. The authority must complete the modernization/rehabilitation efforts and expend more than $1.3 billion, according to various program requirements, by September 2012. In addition, the authority must obligate more than $840 million in HUD funds, about six times its normal level of funding, by the year 2010.

Program	Obligation deadline year		
	2008	2009	2010
Capital funds-2005*	$143,153,018		
Capital funds-2006*		$137,959,152	
Capital funds-2007*			$140,842,826
Capital funds-2008			137,919,872
Financing Program-2008			386,785,824
Capital fund recovery grant			174,579,333
Total	$143,153,018	$137,959,152	$840,127,855

* In June 2008, HUD granted the authority a one-year extension for obligation/expenditure of the funds.

Conclusion

Because the authority did not implement adequate controls and lacked sufficient capacity to administer additional funds allocated under the Recovery Act, it inappropriately obligated more than $32.12 million in Recovery Act funds. The lack of adequate oversight and capacity by the authority to ensure that HUD funds were managed in an economical, efficient, and effective manner is a major concern in light of the authority's receiving additional capital funds under the Recovery Act. Management must improve its internal controls to assure HUD that it can administer the Recovery Act funds in an economical, efficient, and effective manner and achieve program goals.

Recommendations

We recommend that the Director of the Office of Public Housing

3A. Require the authority to deobligate $31.65 million in Recovery Act funds related to the five contracts awarded before the authorized obligation start date and put the funds to better use.

3B. Require the authority to reimburse the capital fund program from nonfederal funds $462,715 paid for ineligible Recovery Act expenditures.

3C. Require the authority to implement adequate procedures and controls to ensure that Recovery Act funds are used effectively and efficiently and in accordance with applicable requirements.

3D. Take appropriate monitoring measures to ensure that the authority complies with all applicable requirements of the Recovery Act.

SCOPE AND METHODOLOGY

To accomplish our objectives, we did the following:

- Reviewed applicable laws, regulations, and other HUD program requirements.
- Obtained an understanding of the authority's management controls and procedures as they related to our objectives.
- Analyzed the authority's obligations and disbursements regarding the Financing Program.
- Interviewed HUD and authority management and staff.
- Reviewed the authority's files and records, including progress and evaluation reports, general ledgers, and bank statements.
- Traced amounts included in progress reports to general ledgers and source documents.
- Reviewed the authority's latest independent public accountant report.
- Selected a sample of 10 projects and reviewed the amounts the authority reported as obligated.[8] These 10 projects represented $250 million of more than $606 million of the total reported obligations for the period ending November 30, 2005. We reviewed the obligations and related supporting documents to determine whether obligations met Financing Program requirements.
- Performed site inspections at three public housing projects to verify the progress of the rehabilitation efforts. We inspected Pedro Rosario Nieves, Jardines de San Fernando, and Jardines de Montellanos public housing projects based on the authority's progress report that showed delays in the rehabilitation efforts.

The authority's records reflected that between December 2003 and September 2008, the Financing Program received more than $69.3 million in program income and that $257,244 of the proceeds had been expended. We examined the authority's records to verify the availability of the unexpended program income. According to the bank statements, $50.3 million in program income had not been spent and the authority could not account for $18.7 million. The authority's internal controls were not sufficient to safeguard its program income and ensure that funds had been used for eligible purposes. Once the proper controls and action plans are developed and implemented, the authority could put the $50.3 million in unused program income to better use and ensure that HUD requirements are met.

[8] We selected a nonstatistical sample and did not use these projects for projecting our sample results.

The authority reported to HUD that it had obligated $32.12 million in Recovery Act funds to five public housing developments as of March 31, 2009. We reviewed the obligations and related supporting documents to determine whether the obligations met HUD requirements.

We conducted our fieldwork from August 2008 through July 2009 at the authority's offices in San Juan, Puerto Rico. Our audit period was December 1, 2003, through July 31, 2008, but we expanded our audit period as needed to accomplish our objectives.

We conducted the 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.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding of assets and resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe that the following items are significant weaknesses:

- The authority's management did not implement adequate controls to effectively plan and coordinate the execution of its Financing Program activities (see finding 1).

- The authority's management did not implement effective controls to safeguard assets and ensure that the financial information on its Financing Program activities was complete and accurate (see finding 2).

- The authority's management did not implement adequate controls and lacked sufficient capacity to administer additional funds allocated under the Recovery Act (see finding 3).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	$57,464,212		
2A		$18,701,107	
2B			$50,354,867
3A			31,659,553
3B	$462,715		
Total	$57,926,927	$18,701,107	$82,014,420

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 those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a 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.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the authority implements recommendation 2B, it will ensure that the unused program income is put to better use for the benefit of the public housing program and its residents and that HUD requirements are met. By implementing recommendation 3A, funds inappropriately obligated by the authority will be available for a more appropriate use consistent with the Recovery Act.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

PUERTO RICO PUBLIC HOUSING ADMINISTRATION

HOUSING DEPARTMENT VIVIENDA COMMONWEALTH OF PUERTO RICO

September 15, 2009

Via Electronic Mail and U.S. Mail

Mr. James D. McKay
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General, Region 4
75 Spring Street, SW , Room 330
Atlanta, Georgia 30303-3388

Re: PRELIMINARY RESPONSE TO DRAFT AUDIT REPORT FOR THE PUERTO RICO PUBLIC HOUSING ADMINISTARTION DATED AUGUST, 21 2009

Dear Mr. McKay:

Comment 1

Attached please find our preliminary response to the proposed findings contained in the draft Audit Report dated August 21, 2009. We appreciate the opportunity granted to our agency to review the proposed findings and be able to provide additional information that we expect should put the Office of the Inspector General in a position to remove or modify the proposed findings before a final Audit Report is issued.

Should you have any questions or need any further information, please do not hesitate to contact us at your convenience.

Sincerely,

Yesef Y. Cordero Lebron, Esq.
Administartor

EQUAL HOUSING OPPORTUNITY

606 Barbosa Avenue, Juan C. Cordero Building, Río Piedras, PO Box 363188 San Juan, Puerto Rico 00936-3188
Phone: (787) 759-9407

Ref to OIG Evaluation **Auditee Comments**

PUERTO RICO PUBLIC HOUSING AUTHORITY'S PRELIMINARY RESPONSE TO AUGUST 21, 2009 DRAFT AUDIT REPORT SEPTEMBER 15, 2009

The Puerto Rico Public Housing Administration ("PRPHA"), the nation's second largest public housing authority, has been at the forefront of undertaking innovative financing strategies that have leveraged hundreds of millions of dollars in private money to bring thousands of obsolete housing units up to 21st century standards. Beginning in 2003, then again in 2008, PRPHA worked with leading legal, financial, and government experts to structure modernization financings so they ensure appropriate investment of public housing funds while, at the same time, providing that the funds are used in accordance with applicable legal requirements. The U.S. Department of Housing and Urban Development ("HUD") approved these financings after months of meetings, countless conference calls, and review of hundreds of pages of documents and due diligence materials. An independent financial expert also thoroughly reviewed these transactions and issued opinions that the transactions were fair and reasonable. Because of its success and innovation, the 2008 transaction was named "Deal of the Year" by *The Bond Buyer*, the nation's leading bond industry publication.

Comment 2

For this reason and the reasons discussed below, PRPHA disagrees strongly with the findings in the HUD Office of Inspector General ("OIG") Draft Audit dated August 21, 2009, ("Draft Audit") which questions whether these transactions met applicable requirements for the use of public housing monies. The Draft Audit's findings are inaccurate, unsupported, and inconsistent with the OIG's own auditing standards. The OIG's conclusions seem to be based on a fundamental misunderstanding of the complex Capital Fund Financing Program ("CFFP") transactions conducted with HUD's approval in 2003 and 2008, the latter of which raised over $200 million in private equity. Collectively, the transactions can bring up to modern standards over 6,500 housing units that have been obsolete for decades. In many places, the Draft Audit does not cite any legal requirements or misapplies existing standards to support its conclusions. Moreover, PRPHA still has not been provided an explanation and documentation sufficient to fully understand the basis for the OIG's conclusions.

Comment 3

Comment 3

As such, PRPHA requests that OIG meet with PRPHA and its team to obtain the necessary explanations and clarifications regarding the 2008 Financing and further requests that OIG revise the Draft Audit to ensure that its findings are both supported and accurate prior to requiring PRPHA to provide a final written response for publication.

RESPONSE TO SPECIFIC FINDINGS

Background

In December 2003, the Puerto Rico Housing Financing Agency, on behalf of PRPHA, issued $663 million in public purpose tax-exempt bonds (the "2003 Financing") to modernize up to 8,256 units in PRPHA's approximately 56,000 unit portfolio. *See* 2003 Bond Official Statement at Exhibit A. As a result of the 2003 Financing, over 3,500 units were modernized.

With rapidly escalating construction costs in Puerto Rico and nationwide over the ensuing months and years, PRPHA found it could not rehabilitate as many units with the 2003

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Financing as it originally hoped. As such, PRPHA took proactive and innovative steps starting in 2007 to enhance the financing program. PRPHA worked with financial, legal and government experts to identify additional funds – which ultimately became part of the 2008 Financing – that would permit the rehabilitation of more units. PRPHA determined that it could generate additional private dollars to rehabilitate more units using low-income housing tax credits ("LIHTCs") in a new transaction that would not spend additional public housing dollars. The additional private funds would enable PRPHA to continue the rehabilitation of the units started by the 2003 Financing and enable the modernization of over 2,000 additional units.

Comment 4

PRPHA completed another CFFP bond issue in 2008 (the "2008 Financing"), which combined private activity, volume cap tax exempt bonds with LIHTCs to leverage an additional $200 million in private equity to rehabilitate more units. To use LIHTCs in the enhanced financing program, PRPHA had to refinance a portion of the 2003 Financing. The use of the 2003 Financing proceeds was restricted to governmental purposes, whereas LIHTCs require the use of private activity bonds. As such, PRPHA had to substitute the type of bonds from governmental purpose bonds to private activity bonds to be eligible for LIHTCs and the additional $200 million in private equity that would be generated by the LIHTCs. To effectuate the foregoing, PRPHA defeased a portion of the 2003 Financing bonds and replaced them with new private activity, volume cap bonds under the 2008 Financing. In short, PRPHA made a technical change in the type of bonds in order to continue and augment the modernization efforts that began with the 2003 Financing. In effect, the two financings combined were a single transaction with the same purpose of modernizing PRPHA's housing stock.

Comment 4

As indicated in PRPHA's June 23, 2008 CFFP Proposal to HUD, and consistent with feedback from HUD, at the closing of the 2008 Financing, an escrow was created to pay all future debt service obligations of the defeased 2003 Financing bonds. *See* June 23, 2008 proposal at Exhibit B. A large portion of the remaining bond proceeds of the 2003 Financing and some of the interest earnings thereon were used to fund the escrow.

Comment 4

The structure of the 2008 Financing, including the defeasance of a portion of the 2003 Financing bonds, was wholly disclosed to HUD prior to receipt of HUD approval. *See* HUD approval at Exhibit C. The transaction was completed only after ensuring that the outside equity investors, underwriters and HUD were comfortable with the legality and financial structure of the deal. The financial transaction was further rated by Standard and Poor's Rating Services (which assigned a rating of "AA-") and Fitch Ratings (which gave a rating of "A+"). As a condition of receiving HUD's approval of the 2008 Financing, PRPHA obtained a "fairness opinion" of the overall financial transaction from an independent, third party financial expert, Public FA, Inc. *See* Exhibit D. The independent expert found that the "overall transaction including the pertinent financing documents …[were] reasonable and well within the parameters of acceptability when compared to other tax-exempt revenue bond transactions of similar size, credit quality and structure." In short, this transaction was consistent with applicable legal requirements and was a financially advantageous use of public housing money.

It is clear the OIG does not fully understand the financial structure and legal requirements applicable to these transactions. This has led to erroneous findings. While this response attempts to address the issues raised by the OIG, PRPHA has not been provided sufficient information to determine exactly how OIG came to its conclusions. As such, we suggest that

Ref to OIG Evaluation **Auditee Comments**

OIG agree to meet with PRPHA and its financing team to review the 2003 and 2008 Financings in detail, as well as the legal support for the use of public housing funds, redraft the report to ensure it is complete and accurate, then provide PRPHA with an opportunity to comment on a new, redrafted version. In the meantime, PRPHA provides the following responses to the OIG's findings to the extent PRPHA understands how they were derived.

Comment 5

1. **Finding 1A: Capital Funds *Can* Be Used to Make Interest Payments on Debt, and the Costs Identified by the OIG Benefited PRPHA Developments and Residents, Thus the OIG's Findings Are Inaccurate.**

(a) OIG Finding: The OIG alleges that PRPHA used more than $57.4 million in Capital Funds to pay for interest expenses on unused borrowed capital that did not benefit the public housing developments or its residents, and was thus unallowable. The OIG cites 2 C.F.R. Part 225 in support of its finding.

(b) Correct Legal Standard: HUD Approval Letters for 2003 and 2008 Financings; 42 U.S.C. §1437G(d)(1); 2 C.F.R. Part 225; and the 2003 and 2008 Financing documents, all of which authorize PRPHA's actions.

(c) PRPHA Response

The OIG incorrectly applied both the facts and the law in this case, thus there is no justification for recapturing funds. The Draft Audit ignores relevant legal requirements and misapplies those requirements that are cited.

Comment 5

Use of Capital Funds for interest payments is authorized by 42 U.S.C. §1437G(d)(1), which specifically permits the use of Capital Fund assistance for "the development, *financing*, and modernization of public housing projects, including the … development of mixed-finance projects." (emphasis added). The Draft Report ignores this statutory authorization. As such, the OIG is without basis to suggest that use of Capital Funds for this purpose is unallowable.

Comment 5

The OIG misapplies 2 C.F.R. Part 225. In fact, this provision actually justifies the expenditures related to the 2003 and 2008 Financings. 2 C.F.R. Part 225 delineates a number of guidelines for expenditure of federal funds by state and local governmental entities, including the one cited by the Draft Audit that provides that costs paid with federal funds are allowable if a relative benefit is received. Without support, the Draft Audit asserts that the defeasance of the unexpended 2003 Financing bonds and, prior to defeasance, the use of Capital Funds for interest payments on those bonds, "did not benefit the authority's public housing program or its residents." To the contrary, there was a clear benefit to public housing clients from this transaction. The 2003 Financing, including the portion that would later be defeased, allowed PRPHA to bid and award construction contracts and commence modernization of units. When a portion of the 2003 Financing was defeased and effectively replaced with private activity, volume cap tax-exempt bonds in the 2008 Financing, the modernization contracts begun under the 2003 Financing continued uninterrupted. The type of bonds used was simply swapped for a type that could be used to generate $200 million in additional private equity and ensure the rehabilitation of over 2,000 additional units. As such, the costs were allowable and benefitted public housing residents.

Ref to OIG Evaluation **Auditee Comments**

Comment 4

2 C.F.R. Part 225 contains additional guidelines with which the 2003 and 2008 Financings complied and which were ignored in the Draft Audit. For example, 2 C.F.R. Part 225, Appendix A(C)(2) provides that a cost is reasonable if "it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost." As indicated above, an independent financial expert determined that the costs associated with the 2008 Financing, including the defeasance of the 2003 Financing bonds, were indeed reasonable. The Draft Audit offers no support to show that these costs were unreasonable. 2 C.F.R. Part 225, Appendix B(23)(b), provides that interest payments *are* an allowable use of federal funds related to construction and renovation of public housing.[1] As a result, there is no basis for the OIG's findings.

(d) Suggested Resolution: The finding should be removed as the transactions complied with the cited HUD requirement.

Comment 6

2. Finding 1B: PRPHA Complied with Applicable Requirements with Respect to Obligation and Expenditure of Capital Funds and Has Full Accounting Records that Support Its Compliance.

(a) OIG Finding: The OIG alleges that an October 2007 request for an extension of obligation deadlines for a portion of the 2003 Financing bond proceeds was "not justified" because the authority had already met the obligation deadline and further alleges that PRPHA lacked information to demonstrate whether an extension of the expenditure deadline of these funds "resulted in a significant increase in rehabilitated units." The OIG cites Section 9(j)(2) of the U.S. Housing Act of 1937 (codified at 42 U.S.C. § 1437g(j)(2)) as the legal standard that supports its findings.

(b) Correct Legal Standard: HUD Approval Letters for 2003 and 2008 Financings; 2003 and 2008 Financing documents; 42 U.S.C. § 1437g(j); 24 C.F.R. § 905.120(b).

(c) PRPHA Response.

PRPHA complied with all legal requirements applicable to obligation and expenditure of Capital Funds used to pay debt service on the 2003 Financing bonds. 42 U.S.C. § 1437g(j)(2), delineates situations under which a housing authority may request an extension of obligation and expenditure deadlines applicable to Capital Funds. Pursuant to 24 C.F.R § 905.120(b), HUD may approve extensions of these deadlines for reasons that, in relevant part, include the following: "(i) The size of the PHA; (ii) The complexity of the capital program of the PHA; (iii) Any limitation on the ability of the PHA to obligate the amounts allocated for the PHA from the Capital Fund in a timely manner as a result of state or local law; or (iv) Such other factors as

[1] The cited provision provides as follows: "Financing costs (including interest) paid or incurred which are associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable subject to the conditions in section 23.b.(1) through (4) of this appendix. Financing costs (including interest) paid or incurred on or after September 1, 1995 for land or associated with otherwise allowable costs of equipment is allowable, subject to the conditions in section 23.b. (1) through (4) of this appendix."

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HUD determines to be relevant." Clearly, PRPHA's size, the complexity of its program, and the significant benefits of the 2003 Financing would warrant an extension if it were needed. There is no legal prohibition on requesting an extension that may not be needed, nor is there any authority that indicated the extension in this case could only be justified if it resulted "in a significant increase in rehabilitated units." As such, the OIG's finding is unsupported. Even if this were a relevant inquiry, any extension that allowed PRPHA to convert the 2003 Financing into the 2008 Financing made possible the modernization of over 2,000 additional units, which is a significant benefit.

Comment 6

The relevant inquiry with respect to obligation and expenditure of Capital Funds, and which is absent from the Draft Audit, is whether PRPHA met all applicable obligation and expenditure deadlines, including any extended deadlines. The answer to this inquiry, which is confirmed in the HUD-approved 2008 Financing's Official Statement, is "yes." *See* Capital Fund Modernization Program Subordinate Bonds, Series 2008 (Non-AMT), p. 26 at Exhibit E, which confirms that each year from 2000 to 2008, PRPHA was in compliance with all applicable deadlines.

(d) Suggested Resolution: The finding should be removed as PRPHA has complied with applicable legal requirements.

3. Finding 1B: PRPHA Complied With Applicable Requirements for Expenditure of Bond Proceeds Under the 2003 and 2008 Financings.

(a) OIG Finding: The OIG alleges that PRPHA violated 24 C.F.R. §968.125 when its rehabilitation efforts funded by the 2003 Financing were delayed and because it did not renovate all of the 8,256 units that were eligible to receive the proceeds of the 2003 Financing bond issue.

(b) Correct Legal Standard: HUD Letter Approving Extension of Obligation and Expenditure Deadlines; HUD Approval Letters for 2003 and 2008 Financings; 2003 and 2008 Financing documents

(c) PRPHA Response

Comment 7

PRPHA complied with all applicable requirements of both the 2003 and 2008 Financing and with HUD requirements, thus the OIG's findings are inaccurate. Contrary to assertions in the Draft Audit, there is no requirement and it was never intended that PRPHA renovate all 8,256 units identified in the 2003 Financing documents, and the failure to do so was by no means evidence of a failure in the modernization program. Under the 2003 Financing, bond proceeds were to be used to rehabilitate up to a *possible* 8,256 units. As is typical of bond transactions, PRPHA was required to identify units which could benefit from bond proceeds in order to define and limit the number of units for which the bond proceeds could be used. PRPHA clearly states in Appendix B to the Official Statement for Capital Funds Program Bonds, Series 2003, that it "reserves the right at its sole discretion, at any time and from time to time, to substitute any of the Projects listed herein [the Appendix] for new Projects." *See* Exhibit A for 2003 Financing Official Statement. As such, the 2003 Financing did not require renovation of specific units, much less a firm number of 8,256. The 2003 Financing required only that the bond proceeds be spent by a time certain on eligible costs, however, there was no requirement to renovate 8,256 units by a certain date.

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As a result of the 2003 Financing, over 3,500 units underwent significant modernization. PRPHA then proceeded to find another way – through the 2008 Financing – to augment the resources available to renovate thousands more units.

Comment 7

The Draft Audit does not cite any applicable legal requirement that has been violated. 24 C.F.R. § 968.125, the provision cited to support the OIG's findings, applies to predecessor program and is not applicable to the current Capital Funds Program. The cited provision provides that modernization under the predecessor CIAP or CGP programs should proceed "in a timely, efficient and economical manner" *after HUD has approved a modernization program and the HA has included the modernization activities in an approved budget or annual statement/Five Year Action Plan.* This provision applies only to activities approved in the annual and five-year planning process under those predecessor programs. It does not apply in the case of the 2003 Financing, as these units were included in a HUD-approved bond transaction and did not use CIAP or CGP funds. As such, the OIG's finding is unsupported.

There is no legal support provided for the OIG's conclusion that PRPHA's modernization efforts were not timely, efficient or economical. As discussed below, PRPHA's actions were reasonable in light of the circumstances surrounding its modernization program and approved by HUD.

(d) Suggested Resolution: The finding should be removed as the Draft Audit has not cited any HUD requirement that has been violated, thus the finding is unsupported.

Comment 8

4. Finding 1B: PRPHA Complied with Applicable Requirements in Carrying Out Modernization Projects, Thus the OIG's Findings Are Inaccurate.

(a) OIG Finding: The OIG alleges that rehabilitation efforts were delayed because there were inadequate controls and administration of the 2003 Financing, which the OIG alleges violates 24 C.F.R. § 968.125. The OIG also alleges that contracts scheduled to terminate after the dates on which 2003 Financing funds were to have been spent is improper.

(b) Correct Legal Standard: HUD Approval Letters for 2003 and 2008 Financings; 2003 and 2008 Financing documents; 24 C.F.R. §85.36

(c) PRPHA Response

PRPHA acted prudently in overseeing and managing the modernization work at each project examined by the OIG. PRPHA's actions were consistent with applicable HUD requirements.

24 C.F.R. § 85.36, as further implemented by HUD's Procurement Handbook, requires housing authorities to safeguard public funds by prudent practices such as establishing appropriate cost controls to ensure that costs charged by contractors are reasonable and by entering into contracts that are fair and reasonable. It does not require PRPHA to proceed with development work if costs are unreasonable, if permits are not in place, or if other federal, local or state requirements have not been met.

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Comment 8

The Draft Audit's findings with respect to several developments incorrectly suggest that the construction delays which arose from PRPHA's prudent practices – such as requiring completion of legally-required environmental studies or negotiating costs with contractors – violated HUD's requirements. To the contrary, it was because PRPHA diligently complied with its responsibilities to protect public dollars that these projects were not completed in accordance with the estimated schedule. The PRPHA's prudence was also required because construction costs had escalated, resulting in change order requests from contractors, and various other conditions had arisen that increased the cost of construction. This is common in construction projects, particularly those with such a large scope. Further, HUD does not require every construction project to meet its original schedule. The OIG has not cited a legal authority that would require these projects to meet a firm or scheduled timetable at any cost nor does such a position advance public policy goals. As such, the Draft Audit's findings related to this issue are unsupported.

Comment 9

Further, there is no requirement that contract end dates and Capital Funds expenditures deadlines should coincide. The 2003 Financing documents were clear that projects could be funding with a combination of bond proceeds and other Capital Funds, and Capital Funds from subsequent years have been used for these contracts. For example, PRPHA has used Capital Funds from 2004, 2006, 2007 and 2008 as well as tax credit proceeds to cover construction costs at the Aristides Chavier development. *See* Exhibit F. As such, there is no correlation between the obligation and expenditure of 2003 Financing proceeds and the dates on which this contract will end. The other contracts examined by the OIG similarly anticipate use of funds other than those from the 2003 Financing. There was no violation of the obligation and expenditure requirements applicable to the 2003 Financing, as such the OIG's finding is unsupported.

(d) Suggested Resolution: This finding should be removed. PRPHA's existing plans for timely rehabilitation efforts are updated each year in its Annual Plan approved by HUD, and are part of the mixed-finance approval from the 2008 financing. The Draft Audit has provided no support for its statement that the construction schedule was not proceeding sufficiently or was unreasonable.

Comment 10

5. Findings 2A and 2B: The OIG Ignored Accounting Records Produced by the Bond Trustee That Fully Account for All Program Income

(a) OIG Finding: The OIG alleges that 24 C.F.R. part 85 and requirements by unnamed HUD officials were violated because PRPHA's internal accounting records do not reflect its accumulation and use of program income in connection with the 2003 and 2008 Financings. The OIG further alleged that PRPHA's fiscal controls are "not sufficient to permit the proper tracing of program income at a level that would ensure that funds had not been used in violation of the applicable statutes."

(b) Correct Legal Standard: HUD Approval Letters for 2003 and 2008 Financings; 2003 and 2008 Financing documents

(c) PRPHA Response:

The bond documents associated with the 2003 and 2008 Financings require that the income generated (program income) from the proceeds be used as part of the overall financing

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structure approved by HUD for specific purposes. All of the funds are used to generate additional money for public housing renovation and associated improvements, thus they benefit public housing residents.

The program income associated with the 2003 and 2008 Financings is accounted for by a trustee who is paid to conduct a detailed accounting of all bond funds, including the program income. *See* Letter from CSG Advisors Incorporated, to James McKay, Regional Inspector General for Audit, dated September 15, 2009, attached as Exhibit K. Under a trust indenture, a trustee has specific and comprehensive responsibilities to safeguard and track every penny of the funds, including earnings, which are also required to be reported to the federal government by the issuer of the 2003 and 2008 bonds to comply with federal tax requirements. Among other obligations, the trustee provides detailed monthly statements on all the funds, including beginning and ending balances, investment earnings, and draws. It appears that the OIG did not review statements by the trustee as part of the audit. Had the OIG done so, the OIG would have understood all program income is clearly accounted for and being used for program purposes. We know of no situation where those records are incorrect or have been questioned in any way. There is no "missing program income" or any other missing funds as the OIG asserts.

Using the primary accounting records provided by the trustee, PRPHA maintains secondary accounting records tracking the bond funds for internal purposes. There is no violation of any requirements when the OIG identified modest delays in PRPHA's accounting reconciliations for these funds under the control of a third-party trustee. This does not represent a significant weakness in accounting or management procedures.

(d) Suggested Resolution: Eliminate these findings because they are unsupported.

Comment 11

6. Finding 2B: Contrary to the OIG's Assertion, PRPHA Spent Program Income in Accordance with the Overall Financing Plan Approved by HUD.

(a) OIG Finding: The OIG cites 24 C.F.R. §85.25, which "encourages" grantees to use program income to defray program costs, to justify its finding that PRPHA officials should be required to develop a plan for use of program income derived from the 2003 Financing.

(b) Correct Legal Standard: HUD Approval Letters; 2003 and 2008 Financing documents, which include a plan for use of all program income generated by the two financings. 24 C.F.R. § 85.25 does not require development of any separate plans.

(c) PRPHA Response:

All program income generated by the 2003 Financing bonds has been placed in the project fund for projects being constructed pursuant to the 2003 Financing Bond issue or in the defeasance escrow for the defeased 2003 Financing bonds or has already been used for projects included in the 2003 Financing. As such, there *is* a plan for all of the program income from the 2003 Financing as it is used to support the financing vehicle that has yielded funds to pay for rehabilitation which HUD approved. PRPHA is not required to develop and maintain separate plans for use of program income, outside of those set forth in the 2003 and 2008 Financing documents. Contrary to the OIG's assertion, this is not required by 24 C.F.R. § 85.25. As such,

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the OIG has no legal basis for its recommendation. The audit's characterization that there are missing or unaccounted for funds is therefore completely incorrect.

(d) Suggested Resolution: Eliminate these findings because they are incorrect and unsupported.

7. Finding 3A and 3B: PRPHA's Use of Funds from the American Recovery and Reinvestment Act ("ARRA") Complies with Statutory Requirements As Interpreted by HUD Under a HUD-Approved Plan, Thus No Recapture or Reprogramming Is Justified.

(a) OIG Finding: The OIG alleges that PRPHA supplanted existing obligations with ARRA funds, which violated the ARRA's requirements. The OIG cites HUD Notice PIH 2009-12 and the HUD ARRA Website as the basis for its allegation.

(b) Correct Legal Standard: ARRA statute; HUD approval of ARRA Annual Statement; HUD Notice PIH 2009-12, which provided guidance on use of ARRA formula Capital Funds; HUD ARRA Website, including guidance dated April 10, 2009 and July 17, 2009.

(c) PRPHA Response:

PRPHA has been and remains in compliance with ARRA requirements.

Comment 12

The Draft Audit erroneously interprets an April 10, 2009, HUD Recovery Act Frequently Asked Questions ("FAQ"), to prohibit use of ARRA funds for pre-existing contracts in all cases.[2] Although this interpretation might apply to certain contracts, it does not apply to those PRPHA contracts examined by the OIG. This is confirmed by a subsequent HUD FAQ dated July 17, 2009, in which HUD made clear that ARRA funds could be used for existing contracts if the housing authority had not issued documentation that bound the agency to make payments until after the obligation start date of the ARRA grant, which is March 18, 2009.[3]

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[2] The April 10, 2009 FAQ at A8: "The PHA must be sure that any obligations it is recording against ARRA funds is for new work that is not previously obligated. PHAs should contact their local field office with questions regarding eligible obligations." The Draft Audit interprets this provision as prohibiting any work that is not "new" without taking into account the fact that ARRA funds may be used for new work previously planned but stalled and, thus, not previously obligated.

[3] Specifically, the July 17, 2009 FAQ at Procurement Q7 and A7 addressed a question related to the ability of a housing authority to use an architect procured previously and under an existing contract with the housing authority for work on the housing authority Capital Fund program work. The housing authority asked whether it could "use the same A&E firm for the ARRA Grant and without going through the bidding process again, because of the shortage of time." HUD responded that as long as "the structure of the contract is such that the PHA is issuing specific tasks against the main contract, the PHA would be able to use [the previously procured and contracted A&E] firm to complete work items requested after the obligation start date of the ARRA grant."

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Comment 12

The contracts at issue in the draft OIG audit are exactly the type of contracts which HUD determined could be utilized. While these contracts were executed prior to March 18, 2009, the date on which ARRA funds became available to PRPHA, the task orders or notices to proceed had not been issued. PRPHA entered into these contracts because it was planning its capital activities for the next few years, which is wholly consistent with the HUD guidance. The contracts clearly state that construction work may not commence until a Notice to Proceed is provided by PRPHA.[4] PRPHA did not incur any obligations, as defined by HUD[5], under the contracts until the spring of 2009, well after the obligation start date of March 18, 2009. Under the contract, no payments could be required nor funds committed to specific obligations until the relevant notices to proceed were issued by the PRPHA. The notices to proceed were issued on May 12, 2009, May 21, 2009, June 16, 2009, July 6, 2009 and July 28, 2009, respectively. *See* Exhibit H for copies of the notices to proceed. Thus, the ARRA Capital Funds were used for obligations that occurred after March 18, 2009, thus they were eligible for ARRA funds under HUD notices and guidance.[6]

The PRPHA's use of ARRA funds to pay for activities under the contracts examined by the OIG was also consistent with HUD's interpretation of the ARRA statute. ARRA provides: "That notwithstanding any other provision of law, the Secretary [of HUD] shall institute measures to ensure that funds provided under this heading shall serve to supplement and not supplant expenditures from other Federal, State, or local sources or funds independently generated by the grantee…". This language does not preclude HUD's interpretation of the statute, as applied to PRPHA's contracts. In Notice PIH 2009-12, HUD addressed this statutory language by explaining that ARRA funds are available for various purposes, including "rehabilitation and modernization activities that have been delayed or not undertaken because of insufficient funds." Although the contracts were executed at the end of 2008, work did not proceed because one of the funding sources originally identified to pay for the work was no longer available, thus PRPHA could not issue the notices to proceed until the ARRA funds were made available.

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[4] *See*, e.g., Article II of the Construction Services Contract for Narcisco Varona Development at Exhibit G, which provides "The Construction Period will commence upon receipt and/or as specified on the Notice to Proceed from the PRPHA to the Contractors."

[5] HUD regulations at 24 C.F.R. § 85.3 define an obligation as "the amounts or orders placed, contracts and subgrants awarded, goods and services received and similar transactions during a given period that will require payment by the grantee during the same or a future period."

Comment 13

[6] At the time the contracts reviewed by the OIG were executed, it was contemplated that part of the cost would be funded by the Government Development Bank of Puerto Rico (the "GDB") line of credit. The contracts were executed in late 2008, however, prior to execution of any notices to proceed, PRPHA determined that the GDB line of credit was no longer an available option as the guaranteed repayment source originally identified was no longer available. The GDB line of credit could not be used without a guaranteed source of repayment. As a result, PRPHA had no source of funds to complete the work originally anticipated to be paid for using the GDB line of credit, thus PRPHA could not and did not issue any notices to proceed under those contracts. The ARRA funds were used to fill the gap in the financing left by the unavailability of the GDB line of credit, which supplemented, and did not supplant funds needed to pay for the work contemplated under the contracts. Absent the ARRA funds, the projects would have been unable to proceed.

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ARRA further states, "public housing agencies shall prioritize capital projects that are already underway or included in the 5-year Capital Fund plans required by the Act (42 U.S.C. 1437c-1(a))." Given the compressed deadlines imposed on obligation and expenditure of ARRA funds, the use of the ARRA Capital Funds on these contracts permitted PRPHA to support projects that were underway, but for which no activity had commenced until after March 18, 2009. Thus ARRA *encouraged* the use of "shovel-ready" projects and PRPHA's use of already-existing contracts to facilitate completion of Recovery Act work was fully consistent with and encouraged by the statute. HUD provided reasonable interpretive guidance to all housing authorities which makes clear that the contracts like those questioned by the OIG did not supplant other funds when the obligations arose after March 18, 2009.

(d) Suggested Resolution: Remove findings regarding deobligation of the nearly $32 million in ARRA funds and reimbursement of $462,714 because PRPHA acted in accordance with HUD guidance and the OIG's findings are unsupported.

Comment 14

8. Findings 3A and 3B: HUD Approved Application of the ARRA Funds for the Contracts Reviewed by the OIG in Accordance with the ARRA Statute

(a) OIG Finding: The OIG alleges that PRPHA could not provide support showing that HUD approved the use of ARRA funds for the five reviewed contracts and that supplanting occurred, in violation of the ARRA Annual Contributions Contract ("ACC").

(b) Correct Legal Standard: ACC for ARRA funds; HUD approval of ARRA Annual Statement; ARRA statute; HUD Notice PIH 2009-12, which provided guidance on use of ARRA formula Capital Funds; HUD ARRA Website, including guidance dated April 10, 2009 and July 17, 2009

(c) PRPHA Response:

The April 10th HUD FAQ referenced above advises PHAs to contact their local field office with questions regarding eligible obligations[7]. As such, PRPHA asked HUD to consider whether ARRA funds could be used for the contracts in question given that the contracts had been executed, but no task orders or notices to proceed had been issued.

On March 25, 2009, PRPHA met with its local field office. Present at the meeting were Domingo Garcia, Robert Lugo and Juan Maroig from HUD Local Office and Marianita Rosa, Carlos López and Diana Suarez from PRPHA. At the meeting, the use of ARRA funds for the five contracts reviewed by the OIG was discussed. PRPHA asked HUD whether these contracts could be utilized, HUD indicated they would consider PRPHA's question and respond shortly. On Friday, March 27, 2009, Domingo Garcia called Carlos Lopez of the PRPHA to confirm that ARRA Capital Funds could not be used to fund costs for which Capital Funds were originally obligated but that PRPHA could use ARRA Capital Funds for construction costs for which a line of credit was identified as the source because the source was no longer available and no notices to proceed had been issued, including under the contracts in question. HUD's advice to PRPHA

[7] See A8 of the April 10, 2009 HUD FAQ.

is documented in an email from Carlos Lopez to Marianita Rosa dated March 27, 2009. *See* email at Exhibit I.

On May 18, 2009, Olga Saez of the Puerto Rico HUD field office approved an ARRA-related Annual Statement revision that included the programming of the ARRA Capital Funds for the five contracts examined by the OIG. *See* HUD approval at Exhibit J. As the HUD field office was already on notice of the circumstances related to the contracts, this approval clearly would not have been obtained if PRPHA improperly supplanted rather than supplemented funding for these projects.

(d) Suggested Resolution: Eliminate findings regarding deobligation of the nearly $32 million in ARRA funds and reimbursement of $462,714 because the OIG's findings are unsupported and based on incomplete facts.[8]

Comment 15

9. Findings 3C-3D: PRPHA Has Adequate Controls in Place to Monitor Its Use of ARRA Funds.

(a) OIG Finding: The OIG claims that PRPHA supplanted ARRA funds for existing obligations on five contracts and should therefore be subjected to additional scrutiny. No legal basis for this finding is cited.

(b) Correct Legal Standard: ARRA statute; HUD approval of ARRA Annual Statement; HUD Notice PIH 2009-12, which provided guidance on use of ARRA formula Capital Funds; HUD ARRA Website, including guidance dated April 10, 2009 and July 17, 2009

(c) PRPHA Response: As explained above, the OIG's findings with respect to the obligation of ARRA funds for the five contracts at issue is without legal support. As such, the suggested remedies of increased controls and monitoring are also without support. ARRA funds already require increased tracking and reporting to HUD; any requirements in excess of those required of other non-troubled housing authorities is unsupported.

(d) Suggested Resolution: Remove these findings because they are unsupported.

Conclusion

The defeasance of a portion of the 2003 Financing bonds was necessary to complete the 2008 Financing, which generated over $200 million in additional private equity that is modernizing public housing units and benefitting public housing residents. Absent these funds, many obsolete units could have been lost. The 2008 Financing was structured by PRPHA in concert with a team of experts, none of whom were consulted by the OIG on an ongoing basis during the ten months in which the Draft Audit was completed. As a result, the OIG misunderstood key elements of the 2008 Financing and issued erroneous findings that are unsupported and inaccurate. The Draft Audit also misapplies standards to its review of the 2003

[8] As discussed above, HUD's reasonable interpretation of the ARRA statute and its approval of the ARRA Annual Statement were consistent with the FAQs published by HUD.

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and 2008 Financings and of PRPHA's use of ARRA funds. As a result, the OIG's findings are without merit and should be removed.

Comment 16

Given the serious misunderstandings and inaccuracies throughout the Draft Audit, PRPHA reiterates its request for the OIG to redraft this report before PRPHA is required to submit a final response to the audit. In anticipation of a redraft of the report, we would be happy to meet with the OIG and the 2008 Financing team to review the 2008 Financing in detail and provide additional documentation to illustrate that all funds connected with the 2008 Financing are monitored in accordance with applicable requirements.

OIG Evaluation of Auditee Comments

Comment 1 The authority stated that it provided additional information that should put OIG into a position to remove or modify the proposed findings.

The additional information provides insight as to why management was unable to respond to changing events but did not justify the authority's inability to fulfill requirements under the Financing Program and the Recovery Act. The authority represented to HUD and bond investors that in return for the funds provided, it would provide specific products and services. Specifically, the authority committed to spending $693 million from its 2003 bond proceeds for the rehabilitation of more than 8,000 units in 44 public housing projects within four years. It modernized only about 3,600 units and placed more than $407 million in unexpended 2003 bond proceeds in escrow with the authority's bond trustee to redeem the bonds as they reached maturity. It did not complete the rehabilitation efforts contained in the 2003 Financing Program proposal and used more than $57.4 million in capital funds to pay for interest expenses on unused borrowed capital that did not benefit the public housing developments or its residents. The authority did not provide additional information to account for more than $18.7 million in program income or justify why its accounting system did not contain accurate and current accounting records. Although Recovery Act funds provided additional Public Housing Capital Fund program funds to create and preserve jobs and to help stabilize the economies of state and local governments, the authority plans to use $32 million of Recovery Act funds to pay the salaries of already employed individuals financed with other funding sources. Accordingly, we did not remove or modify the report findings, conclusions, and recommendations.

Comment 2 The authority asserted that the findings were inaccurate, unsupported, and inconsistent with audit standards.

The findings are supported by source documents the authority provided during the review. The authority did not provide us with any documentation showing that the findings were inaccurate, unsupported, and inconsistent with audit standards.

Comment 3 The authority stated that OIG did not provide an explanation and documentation to fully understand the basis for the conclusions. It also requested to meet with OIG to discuss the 2008 financing and revise the findings.

We discussed the findings with authority officials during the audit (March 2009, May 2009, and July 2009). We discussed the findings and the report with authority officials at the exit conference on September 10, 2009. During the exit conference, authority officials requested some specific documentation pertaining to the audit findings. On September 10, 2009, we sent the authority the requested information.

The audit report did not question the 2008 financing, and the authority did not provide additional documentation that warrants a revision to the findings.

Comment 4 The authority discussed the 2008 financing transactions and asserted that the associated costs were reasonable.

As indicated above, the audit report did not question the 2008 financing or the reasonableness of the associated costs.

Comment 5 The authority commented that capital funds can be used to make interest payments on debt and said the costs were reasonable and benefited public housing residents. The authority cited the statutory provision in 42 USC §1437g(d)(1) and regulations at 2 CFR Part 225 which permits the use of capital fund assistance to finance public housing projects.

While capital funds can be used to pay for the financing of public housing rehabilitation costs, such financing costs are not allocable if the expected benefit is not received. In August 2008, more than $407 million in unexpended 2003 bond proceeds was placed in escrow to redeem the 2003 bonds. Regulations at 2 CFR Part 225, Appendix A, Part C, Number 3, state that a cost is allocable when the goods or services received are assignable to a cost objective "in accordance with relative benefits received." Because such funds were not used to rehabilitate public housing , the relative benefit of paying interest on such unused funds was not received. We contend that the interest paid for the unused funds is unallowable.

Comment 6 The authority asserted that it complied with all legal requirements for obligation and expenditure of Financing Program funds.

We agree that the authority did obligate the 2003 bond proceeds within two years as required by HUD. However, the authority did not expend more than $407 million in 2003 bond proceeds within the prescribed time.

Section 9(j) of the Act required the authority to obligate its Capital Funds within 24 months of the date on which the funds became available. Section 9(j)(5) required the authority to expend its funds within four years of the date on which the funds became available. The statute and HUD's regulations allow for an extension of the expenditure deadline only when the obligation deadline has been extended. When the authority submitted its request for extension of the obligation deadline in October 2007, the authority had previously submitted to HUD the November 2005 Annual Statement/Performance and Evaluation report showing that it had already obligated the funds. We therefore maintain our position that the extension request was not justified.

Comment 7 The authority stated that there was no requirement to renovate 8,256 units and that guidelines in 24 CFR Part 968.125 are not applicable to the Capital Fund program.

The authority's letter to HUD dated November 12, 2003, and HUD's approval letter of December 3, 2003, represented that the 2003 bonds would be used for the rehabilitation of more than 8,000 units in about 40 public housing projects. Our report shows that the authority fell far short of meeting its goal. The authority's assertion that 24 CFR Part 968 is not applicable to the Capital Fund program is incorrect. Guidance in HUD Public and Indian Housing notices for the processing of Capital Fund grants have repeatedly stated that housing authorities agree to comply with Part 968 regulations when signing annual contribution contract (ACC) amendments to receive capital funds.

Comment 8 The authority stated that it complied with applicable requirements in carrying out modernization projects and that examples in the report are the result of prudent practices.

The examples provided in the report illustrate that the authority did not undertake modernization activities in a timely, efficient, and economical manner. The authority records showed that of the 44 proposed projects, only 16 had been completed, 18 were in process, and 10 had not been funded. In addition, some projects were between 314 and 622 days behind schedule. We contend that poor planning and poor coordination contributed to the authority's delays in completing its rehabilitation activities.

Comment 9 The authority stated that there is no requirement that Financing program and project end dates should coincide and that the projects may use other sources of funds. The authority cited project Aristides Chavier as an example of projects using other sources of funds.

Our analysis was based on the contract dates and amounts that were originally obligated for these contracts to the Financing Program including project Aristides Chavier. The authority did not take into consideration the Financing Program expenditure requirement when it executed rehabilitation contracts for 12 housing projects. The contracts had end dates that were between 205 and 921 days after the expenditure deadline. Since the four-year expenditure deadline expired in December 2007, it was improper for the contract end dates to extend beyond that date for contracts to be charged to the 2003 Financing Program.

Comment 10 The authority stated that we ignored records produced by the bond trustee showing that all program income was clearly accounted for and being used for program purposes.

In December 2008, the authority reported to HUD that more than $66 million in unexpended program income was available for future public housing development activities and that the funds remained with the trustee. We used bank statements from the bond trustee to determine the total amount of interest income through September 30, 2008. At the time of our review, the trustee's and the authority's

records did not reflect the disposition of more than $18.7 million in interest income. We clarified the report to indicate that the authority's records did not reflect the disposition of $18.7 million in interest income. Guidelines in 24 CFR 85.20(b) require grantees to maintain accounting records that are accurate, current, and adequately identify the source and application of funds. In addition, Section 15 of the authority's annual contributions contract with HUD requires that the authority must maintain complete and accurate records to permit an effective audit. The authority did not provide additional documentation to show the disposition and eligibility of the $18.7 million in interest income.

Comment 11 The authority asserted that it spent program income in accordance with the financing plan approved by HUD.

The HUD approval letter for the 2003 Financing Program states that interest income will be available for modernization of the authority's public housing properties. However, we did not find a plan for the use of program income as part of our review of the 2003 Financing Program documents. The five-year plan amendment in relation to the 2003 Financing Program indicated: "Interest income generated from the investment of the Bond Proceeds will be used to offset financing costs and any unused interest income will be used for the modernization of properties included in the five (5) year plan." The authority, however, did not use the interest income to offset financing costs and allowed the accumulation of interest income without benefiting the public housing program. We contend that the authority needs to develop a specific plan to ensure that such funds are used for the benefit of the public housing program and its residents.

Comment 12 The authority asserted that the structure of contracts questioned is similar to architectural and engineering type contracts in which specific tasks may be issued against the main contract during the contract period.

The similarity appears to be because notices to proceed had not been issued against such contracts. We disagree with this interpretation. These were not architectural and engineering type contracts. These were construction contracts awarded in 2008 for which other sources of funds (capital funds and local line of credit) were identified in the contracts registered with the state controller's office. Our interpretation is consistent with the definition of obligations in 24 CFR Part 85.3, because the contracts were awarded and would require payment in a current or future period. The tasks to be performed under these contracts were predetermined before the contracts were awarded. This condition is different from architectural and engineering type contracts in which new tasks can be added or changed as the contract period progresses. At the time of our review, two contractors had submitted invoices that the authority paid with Recovery Act funds for services performed prior to the issuance of the notice to proceed and before the authorized obligation start date of March 18, 2009. Therefore, the

authority did incur obligations prior to the obligation start date and before the notices to proceed were issued.

Comment 13 The authority claimed that it determined that the line of credit was no longer an available option to cover the contract costs and that without the ARRA funds, the projects would have been unable to proceed.

The authority did not provide evidence to support the statement during the course of the audit or as part of the comments. The authority did not provide us with additional documentation showing that the Government Development Bank of Puerto Rico cancelled the line of credit and that the contracts were cancelled prior to the obligation start date of March 18, 2009.

Comment 14 The authority contended that HUD approved the inclusion of the questioned contracts for Recovery Act funding.

HUD's letter dated June 2, 2009, advised the authority that Recovery Act funds should be used to supplement expenditures, not to supplant expenditures from other federal, state, or local resources. We contend that the authority did not meet the intent of the Recovery Act requirements by supplanting activities that were to be funded from other sources.

Comment 15 The authority stated that it has adequate controls to monitor the use of Recovery Act funds and requested that we remove the finding because our finding lacks legal support.

The Recovery Act requires that recovery funds shall supplement and not supplant expenditures from other sources. By supplanting previously obligated funds, without support for the assertion that the line of credit was no longer available, the authority violated Recovery Act requirements. In addition, funds that were supposed to provide new and added stimulus to the economy were instead used to pay for old work that was already programmed.

Comment 16 The authority concluded that OIG misunderstood and inaccurately portrayed the actions of the authority and requested that we redraft the report. It also requested to meet with OIG to discuss and review additional documentation associated with the 2008 financing.

We discussed the findings with authority officials during the audit and at the exit conference and requested the authority to provide any additional documentation to justify their actions. The authority provided comments with attachments on September 15, 2009.

We reviewed the additional information provided to us. We determined that the explanations and additional documentation did not justify the authority's inability to fulfill requirements under the Financing Program and the Recovery Act. The

authority did not provide documentation showing that our findings were inaccurate and unsupported. We concluded from the information provided that the authority did not comply with contract requirements as well as HUD rules and the applicable statutes controlling the program. Therefore, we did not modify or remove the report findings, conclusions, and recommendations, and we determined another meeting was not necessary.

As mentioned above, the report did not question the transactions associated with the authority's 2008 financing.

Appendix C

SCHEDULE OF REHABILITATED UNITS

Housing project name	Units proposed for rehabilitation	Units rehabilitated*	Rehabilitation work status
Villa Monserrate	104	0	**
Santiago Iglesia	132	0	**
Felipe Sanches Osorio	186	0	**
EI Manantial	200	0	**
Jardines de Oriente	200	0	**
Los Peña	200	0	**
Las Amapolas	204	0	**
Las Dalias	240	0	**
Nurciso Verona	260	0	**
Puerta de Tierra	484	0	**
El Coral	100	0	In process
Villas del Río	100	0	In process
Jardines de Montellanos	250	0	In process
Jardines de San Fernando	70	13	In process
Lagos de Blasina	240	32	In process
La Esmeralda	84	36	In process
Pedro Rosario Nieves	210	42	In process
Práxedes Santiago	124	44	In process
Catañito Gardens	124	44	In process
Los Mirtos	304	46	In process
Vista Alegre	74	49	In process
Turabo Heights	254	102	In process
Trina Padilla de Sanz	268	137	In process
Jardines de Cupey	308	154	In process
Ext. Sábalos Gardens	300	183	In process
Arístides Chavier	480	204	In process
San Fernando	334	206	In process
Rafael López Nussa	404	296	In process
Ext. Santa Catalina	24	24	Completed
Jardines de Judely	32	32	Completed
Yuquiyú II	70	70	Completed
Alturas de Country Club	72	72	Completed
Las Violetas	88	88	Completed
Marini Farm	100	100	Completed
La Lorenzana	100	100	Completed
Santiago Veve Calzada	100	100	Completed
Roberto Clemente	126	126	Completed
Ponce de León	132	132	Completed
Colinas de Magnolias	148	148	Completed
Andrés Méndez Liceaga	150	150	Completed
Jardines de Cataño	180	180	Completed
Jardines de Campo Rico	196	196	Completed
San Antonio Carioca	200	200	Completed
La Ceiba	300	300	Completed
Total	8,256	3,606	

* Units rehabilitated as of March 2009 according to the authority's progress report.

** Although the authority proposed using 2003 Financing Program proceeds for the rehabilitation efforts, no funds were disbursed for these housing projects.