Dayton Metropolitan Housing Authority

Public Housing Capital Fund Program

Office of Audit, Region 5
Chicago, IL

Audit Report Number: 2016-CH-1012
September 30, 2016

To: Kevin J. Laviano, Director of Public and Indian Housing Hub, 5DPH

//signed//

From: Kelly Anderson, Regional Inspector General for Audit, 5AGA

Subject: The Dayton Metropolitan Housing Authority, Dayton, OH, Did Not Always Follow HUD's and Its Own Requirements for the Procurement of Capital Grant-Funded Contracts

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Dayton Metropolitan Housing Authority's Public Housing Capital Fund program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at **http://www.hudoig.gov**.

If you have any questions or comments about this report, please do not hesitate to call me at 312-353-7832.

Audit Report Number: 2016-CH-1012
Date: September 30, 2016

The Dayton Metropolitan Housing Authority, Dayton, OH, Did Not Always Follow HUD's and Its Own Requirements for the Procurement of Capital Grant-Funded Contracts

Highlights

What We Audited and Why

We audited the Dayton Metropolitan Housing Authority's Public Housing Capital Fund program. We selected the Authority's program for audit based on our analysis of risk factors related to public housing agencies in Region 5's[1] jurisdiction. The audit was part of the activities in our fiscal year 2016 annual audit plan. Our objective was to determine whether the Authority complied with the U.S. Department of Housing and Urban Development's (HUD) and its own procurement requirements.

What We Found

The Authority did not always comply with HUD's and its own procurement requirements. Specifically, it did not (1) prepare adequate independent cost estimates for two contracts, (2) maintain documentation to justify the reason for the significant price difference between the independent cost estimate and the contract price for four contracts, and (3) analyze the cost of the additional items included in the scope of work for three contracts. As a result, HUD and the Authority lacked assurance that (1) nearly $406,000 in capital funds expenses was reasonable and (2) nearly $95,000 in capital funds would be used appropriately.

What We Recommend

We recommend that the Director of HUD's Cleveland Office of Public housing require the Authority to support that the (1) costs paid for two contracts that did not have adequate cost estimates were reasonable or reimburse its Public Housing Capital Fund program, (2) cost paid in excess of the independent cost estimate for one contract was reasonable or reimburse its program, (3) cost paid in excess of the independent cost estimate for one contract was reasonable or deobligate the program funds, (4) costs paid for contract modifications for two contracts were reasonable or reimburse its program, and (5) cost paid for contract modifications for one contract was reasonable or deobligate the program funds. We also recommend that HUD requires the Authority to (1) reimburse the U. S. Treasury from its capital fund account for the costs charged to the incorrect budget line item in HUD's system and (2) implement adequate procedures and controls to address the findings cited in this audit report.

[1] Region 5 includes the States of Illinois, Indiana, Michigan, Minnesota, Ohio and Wisconsin.

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Background and Objective

The Dayton Metropolitan Housing Authority was created in 1934 by the State of Ohio to provide decent, safe, and sanitary housing to low-income households. The Authority's mission is to develop housing solutions for individuals, seniors, and families. It is governed by a seven-member board of commissioners appointed by elected officials. The board's responsibilities include performing duties and functions as required by the Authority's bylaws or its rules and regulations. The Chief Executive Officer has supervision over the administration of the Authority and management of the Authority's housing projects.

The U.S. Department of Housing and Urban Development (HUD) established the public housing program to provide decent and safe rental housing for eligible low-income families, the elderly, and persons with disabilities. HUD provides funds to local housing agencies that manage housing for low-income residents at rents they can afford. The Public Housing Capital Fund program provides financial assistance to public housing agencies and resident management corporations to make improvements to existing public housing. It also provides financial assistance to develop public housing, including mixed-finance developments that contain public housing units. HUD authorized the Authority the following Capital Fund program grants for fiscal years 2013, 2014, and 2015.

Fiscal year	Capital Fund program
2013	$5,634,710
2014	5,359,701
2015	5,068,970
Total	**16,063,381**

Our objective was to determine whether the Authority complied with HUD's and its own procurement requirements.

Results of Audit

Finding: The Authority Did Not Always Comply With HUD's and Its Own Procurement Requirements

The Authority did not always comply with HUD's and its own requirements. Specifically, it did not (1) prepare adequate independent cost estimates for two contracts, (2) maintain documentation to justify the reason for the significant price difference between the independent cost estimate and contract price for four contracts, and (3) estimate the cost of additional items included in the scope of work for three contracts. These weaknesses occurred because the Authority lacked a sufficient understanding of HUD's and its own procurement requirements. As a result, HUD and the Authority lacked assurance that (1) nearly $406,000[2] in program capital funds expenditures was reasonable and (2) nearly $95,000[3] in program capital funds would be used appropriately.

The Authority Did Not Prepare Adequate Independent Cost Estimates

From July 1, 2013, through June 30, 2015, the Authority entered into 15 contracts with 12 contractors, totaling more than $1.9 million in capital funds. We reviewed 5 of the 15 contracts totaling more than $1.5 million to determine whether the Authority complied with HUD's and its own procurement requirements.

The Authority did not prepare adequate independent cost estimates for two of the five contracts. For contract number 1697, the Authority developed a scope of work for the replacement of boilers. It estimated that the services would cost $83,000. The Authority's request for quotations included the scope of work and 13 alternatives to the scope of work. It received quotes from three contractors. The lowest quote for the scope of work was $126,000, and the lowest quote for alternate number 13 was $97,290. The Authority accepted the lowest quote of $97,290 for alternate number 13, and on July 25, 2013, it entered into a contract with the winning contractor. The Authority's independent cost estimate included the cost for the scope of work; however, it did not include the cost for each of the alternates, in particular alternate number 13, to support that the contract price was reasonable.[4] The Authority believed that an independent cost estimate for the alternatives to the scope of work was not required because it had performed a price analysis by comparing the three quotes received. However, since this was a small purchase, the analysis should have also included a comparison to other pricing information, especially since the independent estimate did not include the costs or related information regarding the alternates.[5]

For contract number 1707, the Authority developed a scope of work for door replacement services and six alternatives to the scope of work. The Authority estimated that the work would

[2] 181,290 in recommendation 1A + $44,452 in recommendation 1B + $179,949 in recommendation 1D = $405,691.
[3] $34,928 in recommendation 1C +$59,620 in recommendation 1E = $94,548
[4] 24 CFR 85.36(f)(1)
[5] HUD Procurement handbook 7460 REV-2

cost $120,750. However, the Authority executed a contract with the winning contractor for $84,000, which was more than 30 percent less than the estimate. The Authority's independent cost estimate contained only the estimated total cost. It did not identify the cost elements such as the quantity of the materials to assess price or cost reasonableness. Without this information, we could not determine whether the independent estimate supported the work items detailed in the scope of work. According to the Authority, it was not required to break down the total cost into separate categories, such as labor and material, because HUD's procurement handbook states that for commercially available products, such as doors, less detail was acceptable. HUD's regulations at 24 CFR 85.36(f)(1) state that a cost analysis must be performed when the bidders are required to submit the elements of the estimated cost. The Authority's invitation to bid required the bidders to submit the elements of the estimated cost. Therefore, without an independent cost estimate that identifies the quantity and cost of materials, labor, or any other pertinent information the Authority has no baseline to determine reasonableness of the contract's costs.

The Authority's Procurement Records Did Not Justify Price Differences

Contrary to HUD's requirements,[6] the Authority did not justify the significant difference between the independent cost estimate and the price obtained for the four contracts procured through sealed bids. The variance between the Authority's independent cost estimate and contractors' price exceeded 10 percent for each contract. The following table shows the independent cost estimate for the scope of work, contract price, and the percentage that the contract price exceeded or fell short of the independent cost estimate.

Contract	Independent cost estimate	Contract price	Difference
1698	201,660	246,112	22.04%
1702	194,195	229,123	17.99%
1707	120,750	84,000	-30.43%
1724	1,219,409	888,481	-27.14%

According to the Authority, its interpretation of HUD's procurement handbook[7] was that for sealed bids, it did not need to justify the significant difference between the independent cost estimate and the price awarded as long as there was adequate competition. However, HUD requires the Authority to examine significant variances between the independent cost estimate and lowest competitive bid received and document the reason for a significant variance. Without a comparison for the difference, there was no assurance that the price it paid for each of the four contracts was reasonable.

The Authority Did Not Analyze the Cost of Additional Items

For three of the Authority's contracts (contract numbers 1697, 1702, and 1724), it included additional items that were not part of the original scope of work; however, it did not analyze the cost of the items as required by 24 CFR 85.36(f)(1) and its own procurement policy.

[6] 24 CFR 85.36(f)(1) and HUD's Quick Guide to Cost and Price Analysis
[7] Paragraph 10-3(e) of HUD's procurement handbook

Specifically, for contract 1697, the Authority added seven backflow preventers and seven expansion tanks totaling $1,500 to the scope of work through a change order, dated September 24, 2013, and a pump for $445, for which it did not amend the contract. Therefore, on December 9, 2013, it issued a purchase order for $1,945 ($1,500 + $445). However, it did not analyze the cost of the additional items to ensure that the total price paid was reasonable. According to the Authority, it determined that the costs were reasonable based on information that the contractor initially submitted with its bid and on industry norms. However, since the Authority did not prepare an adequate independent estimate for the original scope of work, reasonableness could not be determined. Further, the Authority mistakenly charged the $1,945 in HUD's Line of Credit Control System[8] to budget line item 1430 for fees and costs, also referred to as soft costs, when the items purchased should have been charged to line item 1460 for dwelling structures, also referred to as hard costs.

For contract 1702, the Authority added three items totaling $8,000 to the scope of work through a change order, dated October 14, 2013. Although the Authority used the allowance for bad soil that was part of its initial contract to pay for the items, it did not analyze the cost for each of these additional items to ensure that the price was reasonable. According to the Authority, since it used the allowance to pay for the work completed, it believed that it complied with HUD's and its own procurement requirements. As a result of our audit, the Authority's architect developed a memorandum that provided a side by side comparison of the change order costs compared to RS Means[9] costs. However, no documentation to support the RS Means costs was provided.

For contract 1724, the Authority added 16 work items totaling $231,569 to the scope of work through eight change orders, dated from December 18, 2014, through November 16, 2015. For these additions, it did not analyze the related costs as required. The Authority's procurement file contained a cost certification for each change order in which its architect certified that the proposed costs were acceptable based on reference manual estimates. The Authority stated that its architect documented the basis for the estimated cost for each item to show that the costs were reasonable. However, neither the Authority's contract file contained documentation of the architect's cost estimates as required[10] nor did the Authority provide us with the estimates. As a result of our audit, the architect developed a memorandum that does a side by side comparison of the change order costs compared to RS Means costs. However, no documentation to support the RS Means costs was provided.

[8] The System is HUD's primary grant disbursement system for handling disbursements for the majority of HUD programs. Grant disbursements are facilitated via the Internet through the System.
[9] RS Means is a division of Reed Business Information that provides cost information to the construction industry so contractors in the industry can provide accurate estimates and projections for their project costs.
[10] Paragraph 3-3(a) of HUD's procurement handbook

Conclusion

The weaknesses described above occurred because the Authority lacked a sufficient understanding of HUD's and its own procurement requirements. As a result, HUD and the Authority lacked assurance that (1) nearly $406,000 in program capital funds was reasonable and (2) nearly $95,000 in program capital funds would be used appropriately.

Recommendations

We recommend that the Director of HUD's Cleveland Office of Public Housing require the Authority to

1A. Support the reasonableness of $181,290 ($97,290 + $84,000) paid for the two contracts (contract numbers 1697 and 1707) that did not have adequate cost estimates or reimburse its Capital Fund program from non-Federal funds.

1B. Support the reasonableness of $44,452 ($246,112 - $201,660) paid in excess of the independent cost estimate for contract number 1698 or reimburse its Capital Fund Financing program from non-Federal funds.[11]

1C. Support that $34,928 ($229,123 - $194,195) paid in excess of the independent cost estimate for contract number 1702 was reasonable or deobligate the funds.[12]

1D. Support that contract modifications totaling $179,949 for two contracts (contract numbers 1702 and 1724) were reasonable.[13] The amount that cannot be shown to be reasonable should be reimbursed to its Capital Fund program from non-Federal funds.

1E. Support that the contract modification totaling $59,620 for contract number 1724 was reasonable. The amount that cannot be shown to be reasonable should be deobligated under its Capital Fund program.

1F. Reimburse the U. S. Treasury from its capital fund account $1,945 charged to the incorrect budget line item in HUD's system.

1G. Implement adequate procedures and controls to ensure that the proper documentation is maintained and contracts are procured and administered in accordance with HUD's and the Authority's procurement requirements. Such

[11] We did not include contract number 1697 because it was included in recommendation 1A and contract number 1702 because it was included in recommendation 1C. Further, we did not question any funds for contract numbers 1707 and 1724 because the independent estimates exceeded the lowest bids. However, the Authority was also required to include a justification or explanation in its procurement records for a significant difference when the independent estimates exceeded the lowest bids.

[12] The Authority used private funding under the Capital Fund Finance program to pay the contractor for contract number 1702 and pledged (obligated) future capital funds to pay for the work. Therefore in this instance, we recommend that the Authority support or deobligate the funds.

[13] $$8,000 from contract number 1702 + $171,949 from contract number 1724. The amount questioned for contract number 1724 was $231,569. However, because the Authority had not yet used $59,620 of the funds as of June 2016, the total amount questioned for this contract was limited to $171,949. The unused amount was included in recommendation 1E. Further, we did not include the $1,500 change order that was added to contract number 1697 because it was included in recommendation 1F.

procedures and controls should include but not be limited to providing training to its contract officer(s) on HUD's and the Authority's procurement requirements.

Scope and Methodology

We performed our audit work from January through July 2016 at the Authority's office located at 400 Wayne Avenue, Dayton, OH, and HUD's Chicago, IL regional office. The audit covered the period July 2013 through June 2015 and was expanded as necessary.

To accomplish our objective, we reviewed

- Applicable laws; Federal regulations at 2 CFR Parts 200, and 225; HUD's regulations at 24 CFR 85, 905, and 990; Office of Public and Indian Housing notices; HUD Handbook 7460.8, REV-2; HUD's Quick Guide to Cost and Price Analysis for HUD Grantees and Funding Recipients; and HUD's Guidebook 7510.
- The Authority's accounting records, annual audited financial statements for fiscal years 2014 and 2015, bank statements; contract and procurement files, policies and procedures, board meeting minutes for July 2013 through November 2014, and annual contributions contract, and data in HUD's Line of Credit Control System.
- HUD's files for the Authority.

In addition, we interviewed the Authority's employees and HUD's staff.

During our review period of July 1, 2013, through June 30, 2015, the Authority entered into 15 contracts with 12 contractors totaling more than $1.9 million in capital fund disbursements. We reviewed the highest 5 (5 different contractors) of the 15 contracts totaling more than $1.5 million of the more than $1.9 million (80 percent) in disbursements to determine whether the Authority procured the goods or services in accordance with HUD's and the Authority's requirements.

We relied in part on the data from HUD's Line of Credit Control System. Although we did not perform a detailed assessment of the reliability of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes.

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 objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls 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 objective:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The Authority lacked a sufficient understanding of HUD's and its own procurement requirements (finding).

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		$181,290	
1B		44,452	
1C			$34,928
1D		179,949	
1E			59,620
1F	$1,945		
Totals	**1,945**	**405,691**	**94,548**

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, implementation of our recommendation will deobligate unreasonable amounts of capital funds and make them available for eligible uses.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1

Greater Dayton Premier Management

Enhancing Neighborhoods • Strengthening Communities • Changing Lives

August 29, 2016

Kelly Anderson
Regional Inspector General for Audit
United States Departments of HUD –
Office of Inspector General
Ralph H. Metcalfe Federal Building
77 West Jackson Boulevard, Room 2201
Chicago, IL 60604

Subject: ***Dayton Metropolitan Housing Authority Response***
Audit Report Number: 2016-CH-100X

Dear. Ms. Anderson:

Please accept the following as the Dayton Metropolitan Housing Authority's ("DMHA" or "Authority") official response to Audit Report 2016-CH-100X ("Draft Audit"). The Authority requests that this response be included in its entirety in the final audit report. According to the Draft Audit, the Office of the Inspector General ("OIG") concluded that the Authority did not 1) provide sufficient details in the cost estimates of two contracts; 2) provide an adequate notation of the price variance between the cost estimate and contract award for five contracts; and 3) provide an adequate cost estimate for change orders in three contracts.

The Authority disagrees with the determinations set forth in the Draft Audit. The Draft Audit contains several ill-founded legal interpretations, factual misstatements and misrepresentations of the HUD requirements. The basis for the Authority's disagreement is further detailed below.

I. The OIG Review Encompassed much more than Five Contracts

The first paragraph of the Draft Audit is misleading in that it states that the objective of the audit was to determine whether the Authority complied with the U.S. Department of Housing and Urban Development's (HUD) and its own procurement requirements. The Draft Audit Report indicated that the OIG's review was limited to five contracts.

The scope of the audit review was much more expansive than a review of the Authority's procurement practices. The scope of the audit included the entire Authority Public Housing

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August 29, 2016
OIG Audit Response

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2

Comment 3

Program.[1] The OIG requested and the Authority provided records pertaining to all aspects of the Authority's Public Housing Program.

The OIG conducted a detailed review of the Authority's financial records for a 24-month period, including all bank statements, payment vouchers, aged receivable reports, journal entries, policies and procedures, operating subsidy submission forms, trial balances, general ledgers and interfund reconciliations.

The OIG's review was much more expansive than the five contracts referenced and the Draft Audit should indicate this.

II. The Authority Complied with the HUD Procurement Requirements and Its Own Policies.

After a thorough review of the Authority's Public Housing Program, the audit resulted in one Finding. According to the Draft Audit Report. *"The Authority Did Not Comply with HUD's and Its Own Procurement Requirements."*

a. The Audit Reports Fails to Identify the Relevant Authority Procurement Policies

The Finding asserted in the Draft Audit Report concludes that the Authority failed to comply with the Authority's Procurement Procedures, yet it fails to address the Authority's procedures in the report itself. The Authority cannot rebut the finding if the Draft Audit fails to set forth the procedures that were not followed. After re-reviewing the relevant procurement files, the Authority asserts that it fully followed its Procurement Policy. In each relevant solicitation, the Authority:

- Created a written Independent Cost Estimate.
- Utilized the appropriate solicitation method.[2]
- The Authority followed all required steps of each solicitation method (advertisement, pre-bid conferences, publication of addendums..etc.)
- After the solicitation closed, the Authority appropriately tabulated the bids
- The Authority evaluated the reasonableness of the contract price for each contract award.
- In all cases, the Authority awarded the contract to the lowest, responsible, responsive bidder.

[1] *See Attached January 6, 2016 Letter from OIG*

[2] *The Draft Audit Report indicates Contract 1697 was a competitive proposal. Specifically it states: "The Authority used competitive proposals for contract number 1697..."* This is clearly erroneous. The estimated cost of the contract was $86,000. The amount was lower than the federal and Authority small purchase threshold. Therefore, the Authority appropriately used the request for quotes method of procurement. The Authority notified the OIG of this error. Despite the Authority's notification of the error, the Draft Audit Report included a determination that the Authority used a Competitive Proposal or Request for Proposal, Qualifications method of procurement.

Ref to OIG Evaluation

Auditee Comments

- The Authority properly executed contracts with each awarded vendor.
- The Authority properly managed each contract.
- The procurement files contains all required records.
- The contracts were appropriately closed out
- Payments were made within the scope of the contract.

III. **Draft Audit Determinations**

The Draft Audit contains three specific determinations. Specifically, it states that the Authority did not:

- Prepare adequate cost independent cost estimates for two contracts.
- Maintain documentation to justify the reason for the significant price variance between the independent cost estimate and the contract price for five contracts; and
- Estimate the cost of the additional items included in the scope of work for three contracts,

Comment 4

IV. RESPONSE TO DETERMINATION #1:
The Authority Prepared Adequate Independent Cost Estimates

The Draft Audit asserts that the Authority failed to prepare adequate cost estimates for Contracts 1697 and 1707. The Draft Audit acknowledges that the Authority prepared written cost estimates. However, it contends that the written cost estimate did not provide enough detail. The Draft Audit predicates its contention on misinterpretations and misapplications of the HUD procurement requirements.

Contract 1697-Boiler Replacements

Prior to solicitation, the Authority prepared a written cost estimate that projected the base contract cost to be $83,000. Since the cost estimate was below the small purchase threshold, the Authority invited contractors to submit quotes to perform the base contract scope of work along with 13 alternate deducts.

Three contractors submitted quotes. The lowest quote was $126,000. Since the lowest quote was above the budgeted contract amount, the Authority applied the alternate deducts. After applying the alternate deducts, the contractor quotes ranged from $97,290 to $144,922.

OIG ISSUE: The Draft Audit concluded that the Authority's written independent cost estimate did not provide enough detail in that it did not provide an individual estimate for each alternate

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

deduct *"to support that the contract cost was reasonable."*[3] The Audit Report cites 24 CFR 85.36(f)(1).

LEGAL REQUIREMENT: An alternate deduct is a defined portion of the work that is priced separately and thus provides an option for the Authority to deduct certain portions of the work to ensure the project can be completed with funds available. If the bids received for a project fall above the amount budgeted, the HA should evaluate the price of the alternate deducts until a price is commensurate with the budget.[4] HUD expressly permits housing authorities (HAs) to utilize alternate deducts when preparing solicitations.[5]

HUD regulations and the HUD Procurement Handbook 7460.8, REV 2, ("Procurement Handbook") state that an agency must make an independent cost estimate before receiving bids or proposals.[6] For small purchases, the Procurement Handbook sets forth the following requirements:

> *"**For purchases above $2,000 but less than the PHA's small purchase threshold,** documentation should be kept to a minimum. The ICE may be based on prior purchases, commercial catalogs, **or** detailed analysis (e.g., purchases for services)."*[7]

The regulations do not specifically address alternate deducts. However, according to the first sentence of regulation cited in the Draft Audit "grantees and subgrantees must perform a cost or price analysis with *every procurement action…*"[8] Assuming *"every procurement action"* encompasses alternate deducts, the requirement is that the Authority should consider the price

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[3] HUD OIG August 12, 2016 Draft Audit Report page 4, paragraph 3 *"The Authority's independent cost estimate included the cost for the scope of work; however, it did not assess the cost for each of the alternates, in particular alternate number 13, to support the contract price was reasonable."*

[4] Although the requirement set-forth in Chapter 6 of the HUD Procurement Handbook do not apply to purchases below the small-purchase threshold, this is the guidance provided by HUD on the use of Alternate Deducts in the Procurement Handbook or regulation. **Procurement Handbook, page 6-7, 6.12** A. *Evaluate Bids & Any Alternates 1. The apparent low bid should be evaluated according to the procedures outlined in the paragraphs below. If the apparent low bid exceeds the project budget, any deduct alternates should be applied to the bid prices, one at a time, to identify the bidder whose resulting price falls within the budget. If the first deduct alternate does not produce an acceptable bid, then the second alternate should be applied, and so on, until an acceptable price and bidder is identified. 2. If alternates are employed, and the apparent low bid falls below the available budget, a similar process of applying the alternates one at a time may be employed to identify the low bidder who includes the greatest number of alternates within the available funding. 3. The PHA should not use alternate prices as a way to select a preferred bidder.*

[5] **HUD Procurement Handbook No. 7460.8 Rev2 ("Procurement Handbook") page 6-1, 6.4** *"Alternate Bids PHAs should not request alternate bids, i.e., two different systems or types of projects. Instead, when necessary because of limited available funding, a PHA may specify the most expensive system as the base bid and list deductive alternates in inverse priority order. Thus, in the case of limited funding, deductive alternates may be taken in numerical order as listed until the award can be made within available funds."*

[6] **24 CFR 85.36(f)(1)** and **HUD Procurement Handbook, page 3-1 -3-2.**

[7] **Procurement Handbook, page 3-2,** 3.2(D)(1)

[8] **24 CFR 85.36(f)(1);**

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Comment 4

Comment 5

Comment 4

reasonableness of alternate deducts. Neither the regulation nor the Procurement Handbook contains a requirement that the Authority provide a cost estimate for each alternate deduct.

Analysis: Contrary to the Draft Audit's interpretation, Part 85 does not require housing authorities to complete a cost estimate for each alternate deduct. If HUD intended to require a cost estimate for each deduct, it would have expressly stated so. Additionally, since the Authority appropriately utilized the small purchase method of solicitation, it was required, by HUD, to keep the cost estimate documentation to a minimum.[9]

Here, GDPM appropriately prepared a written cost estimate for the base contract. After receiving 3 proposals, GDPM applied the alternate deducts, one at a time, until it could identify the bidder whose price fell within budget. It then determined the price reasonableness by a comparison of the three proposed prices received.[10]

The Draft Audit erroneously claims that the requirement to prepare an individual cost estimate for every alternate deduct is couched in the sentence *"..85.36(f)(1) states that grantees must make independent estimates before receiving bids or proposals."* This sentence does not contain any language that could be construed as applying to every alternate deduct. It just states that a cost estimate must be prepared. If HUD intended to have this sentence apply to alternate deducts it would have stated so. This is especially true since the first sentence of the cited regulation specifically states that a cost/price analysis must be prepared for "every procurement action." If HUD intended for cost estimates to include every alternate deduct, HUD could have included "for every procurement action" or "including alternate deducts" to the end of the sentence.

Additionally, if HUD intended to require HAs to prepare a cost estimate for every alternate deduct, it's guidance in the Procurement Handbook would provide for this. There is not a single mention in the Procurement Handbook about a requirement to prepare a cost estimate for alternate deducts.

The Authority followed the exact language of the regulation and prepared the cost estimate prior to receiving bids. After receiving bids, it properly evaluated the costs, determined the base bids were higher than the projected budget. It then applied the alternate deducts in inverse order until the work could be completed within the projected budget. It then contemplated and determined price reasonableness of the alternate deducts, as indicated on the bid tabulation sheet (*Figure 1*). Therefore, the Authority appropriately prepared

ict	Alt Deduct 12	Alt Deduct 13	Total Deducts	Bid with Deducts
)	150.00	150.00	40,009.00	144,922.0(
10	$185.00	$185.00	$30,782.00	$108,846.(
10	$150.00	$150.00	$28,710.00	

Figure 1

[9] ***Procurement Handbook Page 3-2,*** *3.2(D)(1) "For purchases above $2,000 but less than the PHA's small purchase threshold,* ***documentation should be kept to a minimum.*** *The ICE may be based on prior purchases, commercial catalogs,* ***or*** *detailed analysis (e.g., purchases for services)."*

[10] **Procurement Handbook Page 5-2, 5.5(2)** *"Generally, price analysis will consist of a comparison of quotations to each other..."*

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Comment 4

the cost estimate for Contract 1697. The Draft Audit should be revised to exclude a determination that the Authority did not adequately prepare its cost estimate for Contract 1697. And, the Draft Audit Recommendation 1A should be revised to the extent that the recommendation is based upon the Contract 1697 cost estimate.[11]

Contract 1707 – Door Replacements

Comment 4

The Draft Audit also asserts that the Authority did not prepare an adequate cost estimate for Contract 1707. Prior to solicitation, the Authority prepared a written cost estimate that projected the contract cost to be $120,750. The quote sheet contained quote lines for materials and labor and for the total proposed contract cost (*Figure 2*).

1. BASE BID:	
Labor	$_____
Material	$_____
Total	$

Figure 2

Because the cost estimate was above the small purchase threshold, the Authority utilized the sealed bid method of procurement. It received seven proposals ranging in price from $84,000 to $125,000.

After receiving the seven 7 proposals, the Authority reviewed the submissions and tabulated the bids for comparison.[12] Thereafter, the Authority drafted a Memorandum to its Board of Housing Commissioners that summarized the procurement, quotes received and price reasonableness determination.[13] Ultimately, The Authority awarded the contract for the proposed cost of $84,000.

Comment 6

OIG Issue: The Draft Audit concludes that because the bid sheet contained quote lines for labor, material, and total contract price, the Authority should have prepared a cost estimate that contained individual estimates for the same items. According to the Draft Audit:

> *"However, HUD's regulations at 24 CFR 85.36(f)(1) states that a **cost analysis** must be performed when the bidders are required to submit the elements of the estimated cost."*[14]

It is apparent from the above statement that the Audit Report confuses the requirement for a "cost analysis" with the requirement for a "cost estimate". The Draft Audit seems to erroneously use these terms interchangeably. However, the Authority, HUD regulations and Procurement Handbook differentiate between the two terms, "cost analysis" and "cost estimate."

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[11] **Draft Audit Report Page 6, Recommendation 1A**, *"Support the reasonableness of $181,290 ($(7,290 + $84,000) paid for the two contracts (contract numbers 1697 and 1707) that did not have adequate cost estimate or reimburse its Capital Fund program from non-Federal funds."*

[12] *Proposals and Bid Tabulation Sheets are part of the Contract 1707 Procurement File and have been previously provided to OIG in March, June, and August 2016.*

[13] *The Board Memorandum is part of the Contract 1707 Procurement File and was provided to OIG in March and June 2016*

[14] *See Draft Audit Report at Page 5 Paragraph 1.*

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Legal Requirement - Cost Estimate: HUD regulations at 24 CRR Part 85 and the Procurement Handbook require housing authorities to prepare an independent cost estimate prior to each solicitation. The Authority's Procurement Policy reiterates this. The cost estimate serves as the Authority's yardstick when evaluating a Contractor's proposed price. The level of detail in a cost estimate will vary, but should be commensurate with the value, complexity, and commercial nature of the requirement. The Procurement Handbook states that cost estimates may be broken out into major categories of cost, but a HA may also not need to break out components.[15]

Legal Requirement for Cost Analysis: If, under a competitive proposal, a housing authority requests the bidder to provide separate elements of costs in its proposal, the housing authority shall prepare a cost analysis.[16] However, this requirement does not apply to sealed bids. If HUD intended for this to apply to sealed bids, it would have stated so since it specifically states that it applies to competitive proposals. "Sealed bids" and "competitive proposals" are two separate and distinct methods of solicitation. Additionally, HUD specifically exempts construction contracts obtained through sealed bids from the requirement of preforming a cost analysis.[17]

The following table summarizes the Procurement Handbook's *"Situations Requiring a Cost Analysis:"*

Situation Requiring Cost Analysis	Application to Contract 1707
All sole source and non- competitive proposals	1707 is neither sole source nor non-competitive. It was a sealed bid.
HA receives only one bid/proposal and cancels solicitation in order to negotiate price	1707 received 7 reasonable proposals ranging from $84,000-$125,000
HA doesn't receive a sufficient amount of bids	1707 received 7 proposals
If, under competitive proposals, the PHA requested the bidder to provide separate elements.	1707 was a sealed bid, not a competitive proposal.
Contract Modifications	1707 does not include a contract modification
When making contract termination payments	1707 did not include a termination payment.
When awarding any construction contracts obtained though means other than sealed bid.	1707 was a construction contract obtained through a sealed bid solicitation.

[15] **Procurement Handbook, Page 3-2,** *3.2(d)(3) For purchases above the PHA's small purchase threshold, the level of detail will vary but should be commensurate with the size (i.e., dollar value), complexity, and commercial nature of the requirement. ICEs are normally broken out into major categories of cost (e.g., labor, materials, and other direct costs such as travel, overhead, and profit). Commercially available products and services may require less detail as the marketplace tends to provide current reliable pricing information for commercially available products; a PHA may also not need to break out components. Non-commercial type requirements, and work designed specifically for the PHA, will require much more extensive estimation and a detailed ICE.*

[16] **Procurement Handbook, Page 10-16, 10.3(c):** *Situations Requiring a Cost Analysis: A cost analysis must be conducted if one or more of the following conditions apply: 4. If, under competitive proposals, the PHA requested that bidders provide separate elements of their costs, e.g., labor, materials, overhead, profit, etc. (Note: it will not be necessary in most competitive procurements to ask for bidders to submit separate elements of their costs. For example, if a PHA is soliciting property management services, the PHA should not need to request a break-out of costs since one can generally evaluate the reasonableness of management fees without such break-down).*

[17] *Id.* 7. When awarding any construction contracts that were obtained through means other than sealed bidding. Construction contracts awarded using any method other than sealed bidding and modifications to construction contracts require cost analysis.

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Comment 7	**Analysis:** Because Contract 1707 was a construction contract that was procured using the sealed bid method of solicitation, it is specifically exempted, by HUD, from the cost analysis requirement. Prior to solicitation, the Authority prepared its written cost estimate projecting the contract cost to be $120,750. More than adequate competition existed as the Authority received seven (7) proposals ranging from $84,000 to $125,000.
	Even though the bid sheet contained separate line items for the cost of labor, materials, and total contract cost, the Authority was not required to provide individual cost estimates for each line item. Here, the written cost estimate indicates that the projected contract cost was based upon industry norms for replacing doors; a typical commercially available product and service.
Comment 8	The purpose of the cost estimate is to establish a yardstick for the Authority to measure cost reasonableness. Here, the Authority prepared a written cost estimate that was within the range of the bids. The Authority's estimate was 6.7% less than the next highest bid and the bid closet to the actual contract price was only 1.6% higher than the contract price. The Authority obtained a sufficient amount of bids to demonstrate the contract was awarded competitively and the after comparison of the bids, it is apparent that the costs were reasonable. Therefore, any lack of a detailed independent cost estimate had absolutely no effect on the contract costs or price reasonableness determination.
Comment 6 Comment 4	Lastly, the Draft Audit erroneously misapplies the cost analysis requirements to the cost estimate. A "cost estimate" and a "cost analysis" are separate and distinct with differing requirements. The Authority prepared its written cost estimate for Contract 1707. It was not required to provide separate estimates for labor and materials as asserted by the Draft Audit. Additionally, the Authority wasn't required to perform a cost analysis. However, the Authority fulfilled its obligation and demonstrated, through the bids received, bid tabulation sheet, and Memorandum to the Board of Housing Commissioners that it contemplated and determined price reasonableness.
Comments 6 and 7	The Authority appropriately prepared the cost estimate for Contract 1707. The Draft Audit should be revised to exclude a determination that the Authority did not adequately prepare its cost estimate for Contract 1707. And, the Draft Audit Recommendation 1A should be revised to the extent that the recommendation is based upon the Contract 1707 cost estimate.[18]
Comment 4	**OIG Determination #1 Conclusion:** The Draft Audit misinterprets and misapplies the HUD regulations and the Procurement Handbook provisions relating to the cost estimate and cost analysis to Contracts 1697 and 1707. In both instances, the Authority developed a written independent cost estimate prior to the solicitation. The Auditor suggests that the cost estimates were not detailed enough. However, the authority relied upon in the Audit Report does not apply to either of these two contracts.

[18] **Draft Audit Report Page 6, Recommendation 1A**, *"Support the reasonableness of $181,290 ($(7,290 + $84,000) paid for the two contracts (contract numbers 1697 and 1707) that did not have adequate cost estimate or reimburse its Capital Fund program from non-Federal funds."*

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Comments 5 and 8

Comment 2

The purpose of the cost estimate is to provide the housing authority with a yardstick to measure cost reasonableness. In both instances, ample competition existed and it is clear that when comparing the proposed prices, the contract costs were reasonable. The Authority followed HUD's and its own procurement requirements. Therefore, the final Draft Audit should not contain the determination that the Authority did not adequately prepare its cost estimates. Recommendation 1A should be deleted in its entirety

V. ***REPONSE TO DRAFT AUDIT DETERMINATION #2:***
Although there were differences between the cost estimate and the contract price, the contract prices were reasonable and the Authority followed HUD's and its own procurement requirements.

Comment 9

The Draft Audit determined that the Authority's procurement records did not contain explanations for the differences between the cost estimates and contract prices for five contracts. The Draft Report arbitrarily concludes that a 10% difference between the cost estimate and contract award equates to a "significant price variance" and therefore, triggers an additional requirement that the Authority include a price variance notation in the procurement file. The Draft Audit expressly concludes that:

> *"Regardless of the procurement method used, HUD's Handbook required the Authority to document the reason for the significant price variance between the independent cost estimate and price quote. Without an explanation for the difference, there was no assurance that the price it paid for each of the five contracts was reasonable."*[19]

Comment 10

The only authority cited as the basis for this assertion is HUD Procurement Handbook 10.3(E). The Authority contends that the Draft Audit misinterprets and misapplies 10.3.(E). In summary, the Authority contends that:

Comments 3 and 11

- The requirement to notate the file applies to competitive proposals only and therefore, does not apply to any of the five contracts at issue.

Comment 9

- Additionally, the HUD Procurement Handbook expressly states that 10.3 applies to purchases over the federal small purchase threshold. Contracts 1697 and 1707 were purchases below the small purchase threshold.

Comment 12

- HUD does not have a requirement that any contract cost over 10% of a cost estimate constitutes a significant price variance.

Comment 10

- All five contracts had sufficient competition and, in each circumstance, a comparison of the proposed prices demonstrate price reasonableness.
- Although it was not a requirement, the procurement files for Contracts 1707, 1698, 1702, and 1724 all contain a price variance notation.

[19] *See Draft Audit Report, Page 5, Paragraph 2*

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Comment 10 Comment 7	

Legal Analysis: Neither the HUD regulations nor the Procurement Handbook require that a housing authority notate its procurement files at any time the contract price varies significantly from the cost estimate. The Draft Audit contends that the Procurement Handbook 10.3 (E) sets forth this requirement. However, the only sentence in 10.3(E)[20] that refers to a price variance notation refers to competitive proposals only. It does not apply to small purchases or to sealed bids.

10.3 is entitled *Evaluating Cost and Price* ***(For Purchases above the Federal Small Purchase Threshold).*** The title expressly states that any requirements contained in 10.3 do not apply to small purchases.[21]

Additionally, Paragraph 10.3(E)'s last sentence does not apply to sealed bids. With the exception of Appendix A, the sentence contains the only reference in the Procurement Handbook (and regulations) about a significant price variance between the contract cost and cost estimate. The sentence immediately prior to the last sentence refers to competitive proposals.

When applying the general rules of sentence construction, it is apparent that the use of the conjunctive adverb "however" at the beginning of the sentence indicates that the sentence refers to the sentence immediately prior. Since the sentence immediately prior refers to competitive proposals exclusively, the price variance sentence also refers exclusively to competitive proposals. It does not apply to sealed bids. If it applied to sealed bids, there would have to be an express statement indicating that it applied to sealed bids.

This position is further demonstrated in the sample procurement policy contained in Appendix 1 of the Procurement Handbook, and adopted by the Authority. The Sample Policy states:

> ***Sealed Bids*** *The presence of adequate competition should generally be sufficient to establish price reasonableness. Where sufficient bids are not received,* ***and*** *when the bid received is substantially more than the ICE,* ***and*** *where the FHA cannot reasonably determine price reasonableness, the FHA must conduct a cost analysis, consistent with federal guidelines, to ensure that the price paid is reasonable.*
>
> ***Competitive Proposals*** *The presence of adequate competition should generally be sufficient to establish price reasonableness. Where sufficient bids are not received, the FHA must compare the price with the ICE. For competitive proposals where prices cannot be easily compared among offerors, where there is not adequate competition,* ***or*** *where*

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[20] **Procurement Handbook 10.3(E):** *With respect to price reasonableness, the procurement file should be documented to support the actions taken. In the case of sealed bids where there was adequate competition, no additional documentation is required in that the bid tabulation sheet, or equivalent, will serve as the test of price reasonableness. Similarly, in the case of competitive proposals where (1) there was adequate competition, (2) the scope of work was not complex (easy to evaluate competing bids), and (3) the PHA did not ask the vendor to break out elements of costs separately, no additional documentation is required for price reasonableness other than the comparison of prices offered. However, documentation is required to demonstrate price reasonableness, including any cost analyses, whenever (1) adequate competition did not exist, (2) adequate competition existed but the PHA received only one bid/proposal, or (3) the price obtained varied significantly from the ICE, in which case the Contracting Officer should notate/explain the reasons for the difference, e.g., poor estimate, etc.*

[21] ***Procurement Handbook page 10-14, 10.3***

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the price is substantially greater than the ICE, the FHA must conduct a cost analysis, consistent with Federal guidelines, to ensure that the price paid is reasonable.[22]

The above paragraph referring to competitive proposals mimics (almost verbatim) the last sentence of paragraph 10.3(E):

> *"However, documentation is required to demonstrate price reasonableness, including any cost analyses, whenever (1) adequate competition did not exist, (2) adequate competition existed but the PHA received only one bid/proposal,* ***or*** *(3) the price obtained varied significantly from the ICE, in which case the Contracting Officer should notate/explain the reasons for the difference, e.g., poor estimate, etc."*

The sample policy's requirement for sealed bids states that the cost analysis is required only when there are insufficient bids **AND** a substantial variation between contract price and cost estimate. This differs from the policy's section about competitive proposals and paragraph 10.3(E) - "if there is inadequate competition **OR** a substantial price difference....." It is evident that the last sentence of 10.3(E) does not apply to sealed bids. And, it is evident from the sample policy and the structure of paragraph 10.3(E) that HUD did not intend for the last sentence to apply to sealed bids. To conclude otherwise would result in a finding that the HUD sample procurement policy does not conform to the HUD requirements.

Furthermore, according to paragraph 10.3(E), the reason to notate the file when the contract price and cost estimate vary significantly is to establish price reasonableness. The beginning of paragraph 10.3(E) includes the following statement:

> *"In the case of sealed bids where there was adequate competition, no additional documentation is required in that the bid tabulation sheet, or equivalent, will serve as the test of price reasonableness."*

Therefore, as long as adequate competition exists, the housing authority will demonstrate price reasonableness with a comparison of the proposals as documented on the bid tabulation sheets.

Comment 9

III. Procurement Handbook Does not indicate a 10% Substantial Difference Threshold

If HUD determines the requirement to prepare a price variance notation applies to every solicitation method, then it must determine what constitutes a significant difference. The HUD Procurement Handbook, prior OIG audits and the regulations do not clarify what constitutes a significant difference.

The sample procurement policy in the HUD Procurement Handbook indicates that a cost analysis is needed if the price is substantially ***greater*** than the cost estimate. . Here, most of the contracts prices were within 80% of the cost estimate. The contract prices with the most significant

[22] ***Procurement Handbook page a-8***

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variance from the cost estimate were instances when the contract price was actually **lower** than the cost estimate. The other contract prices were within 78 %– 86% of the cost estimate.

During the Draft Audit Exit Conference, the auditor indicated that any contract price that differs more than 10% from the cost estimate would constitute a "significant difference." However, this threshold is not a written requirement or a generally known threshold. Therefore, to base a finding upon this subjective threshold would be fundamentally unfair to the Authority and would have to include a determination that the Authority's test of price reasonableness is not adequate or reasonable. Therefore, the 10% threshold should not be the measurement of cost reasonableness when reviewing the five contract in question. Instead, since the Authority determined and demonstrated the price reasonableness by comparing the proposals HUD should reverse its determination on this issue. A further analysis for each of the five contract is below.

Comments 3 and 11

DETERMINATION #2: Application to Authority Contracts

Contracts 1697 & 1707: Contrary to the Draft Audit determination, the Authority did not use the Competitive proposal method of solicitation for Contract 1697.[23] It used the small purchase, request for quotes method of solicitation. The contract award cost for Contract 1697 was $97,290. The contract award cost for Contract 1707 was $84,000. Both contracts awards were below the small purchase threshold, therefore, 10.3 does not apply.

Comment 5

Nonetheless, the Authority established price reasonableness for both contracts. Three contractors submitted proposals for Contract 1697. The quotes ranged from $97,290-$144,922. The winning bid was 11.8% lower than the next highest bid.

Comment 8

Seven contractors submitted quotes for Contract 1707. The quotes ranged from $84,000 to $125,000. The Authority cost estimate was $120,750. The ultimate award was less than the cost estimate. Additionally, the procurement file contained a memorandum discussing the price difference. Specifically, it stated:

> *"The bids received **varied greatly** when compared to the probable cost identified by GDPM. However, the bids received must be reflective of the true cost of the work of the project and the competitive bidding environment.*
>
> *Per HUD Handbook 7460.08 REV 2, 10.3(B), there are alternative methods of determining that a price is reasonable than a cost analysis. A comparison of proposed prices received in response to the solicitation to each other is generally sufficient to establish price reasonableness, assuming a sufficient number of competitive offers are received to constitute competitive pricing from the*

[23] **Draft Audit Report page 5, paragraph 3** *"The Authority used competitive proposals for contract number 1697…"*

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marketplace. The average proposed price of the seven bids received on February 14, 2014 is $98,584.42."[24]

The memorandum then concludes by stating that the Authority determined the contract price was fair and reasonable as related to the other bids.

Comments 3, 10, 11, and 12

Because contracts 1707 and 1697 were below the small purchase threshold, 10.3 does not apply. Nonetheless, the Authority contemplated and demonstrated cost reasonableness prior to the contract awards and provided a price variance notation in the Contract 1707 procurement file. Therefore, these contracts should be excluded from the determination that the Authority failed to follow the requirement set-forth in 10.3(E). Any Audit Report Recommendation that relates to or will relate to the price variance between cost estimate and contract cost should be edited to exclude any recommendation related to Contract 1707 and 1697.

Contract 1698 – Window Replacement.

Comment 10

The Authority estimated the cost of Contract 1698 to be $201,660. Using the sealed bid method, it received five quotes ranging from $246,112 to $499,000. The requirement to notate the file does not apply to sealed bids. Therefore, the contract is in compliance with HUD's and its own Procurement Policy.

Nonetheless, the Authority provided a price variance notation the procurement file. A board memorandum dated October 16, 2013 was part of the procurement file and provided to the Auditor.[25] According to the memorandum:

"Five bids were received for the project. The bids received ranged from a low of $388,610 to a high of $618,000. The estimate of probable cost identified by Craig E. Dillon Architects is $367,214.

The lowest bidder for the project is Tri-State Renovations. Their total base bid minus Alternate Deduct 1 for the project is $246,112 and is within the 80% threshold of the estimate of probable cost minus Alternate Deduct of $206,660 identified by Craig. E. Dillon Architects."

Comments 9 and 12

It is apparent that the Authority contemplated cost reasonableness as related to the price variance of the bids as compared to the cost estimate. It determined that the cost was within 80% of the cost estimate and therefore, considered the price to be reasonable.

[24] *Authority Board of Housing Commissioners Memorandum, February 19, 2014. Previously provided in March and June 2016.*
[25] *Authority Board of Housing Commissioners Memorandum, October 16, 2013. Previously provided in March and June 2016.*

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Comment 10

The Authority was not required to notate the procurement file. Nonetheless, the file contains a notation indicating that the Authority contemplated price reasonableness despite the variance. Therefore, HUD should determine that the Authority followed HUD's and its own Procurement requirements with regard to Contract 1698 and any Recommendation that relates to Contract 1698 and the price variance, including Recommendation 1B, should be reversed or deleted in its entirety.

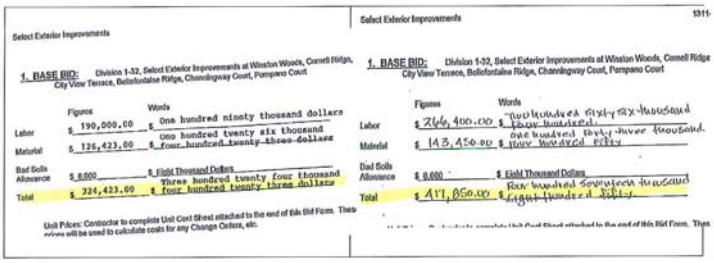
Comment 10

Contract 1702-Exterior Improvements

Contrary to the Audit Report's conclusion, the Authority was not required to notate the difference between the cost estimate and contract award in the procurement file for Contract 1702. The Authority utilized the sealed method of procurement. Therefore, the requirement to notate the file does not apply to sealed bids.

Comment 13

However, the Draft Audit contain an inaccurate calculation of the price variance. Also, the Authority provided a price variance notation in the procurement file. The Authority estimated the cost of Contract 1702 to be $289,070. It used the sealed bid method of procurement and received two quotes ranging from $324,423 to $417,850. Both quotes contained a line item for an $8,000 "Bad Soil" allowance.



Select Exterior Improvements

1. BASE BID: Division 1-32, Select Exterior Improvements at Winston Woods, Cornell Ridge, City View Terrace, Bellefontaine Ridge, Chanvingway Court, Pompano Court

	Figures	Words
Labor	$ 190,000.00	One hundred ninety thousand dollars
Material	$ 126,423.00	One hundred twenty six thousand Four hundred twenty three dollars
Bad Soils Allowance	$ 8,000	$ Eight Thousand Dollars
Total	$ 324,423.00	Three hundred twenty four thousand $ four hundred twenty three dollars

Unit Prices: Contractor to complete Unit Cost Sheet attached to the end of this Bid Form. These prices will be used to calculate costs for any Change Orders, etc.

Select Exterior Improvements 1311

1. BASE BID: Division 1-32, Select Exterior Improvements at Winston Woods, Cornell Ridge City View Terrace, Bellefontaine Ridge, Chanvingway Court, Pompano Court

	Figures	Words
Labor	$ 266,400.00	$ Two hundred sixty-six thousand four hundred.
Material	$ 143,450.00	$ One hundred forty-three thousand four hundred fifty
Bad Soils Allowance	$ 8,000	$ Eight Thousand Dollars
Total	$ 417,850.00	$ Four hundred seventeen thousand eight hundred fifty

Comment 10

Since the amount was an allowance, the $8,000 was not included in the cost estimate. The auditor, when calculating the difference between the cost estimate and contract award, included the $8,000 in the contract amount. To calculate the true difference, $8,000 should be deducted from the Contract amount. Therefore, the contract price is only 14% higher than the cost estimate.

Despite the smaller difference between the cost estimate and contract award and despite the lack of a requirement to notate the file, the procurement file contains a notation about the price

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Comment 10

Comments 9, 10, and 12

Comment 10 and 12

variance. Specially, a Memorandum to the Board of Housing Commissioners dated August 21, 2013 states:

> *"Two bids were received for the project. The bids received ranged from a low of $324,423 to a high of $417,850. The estimate of probable cost identified by Oregon Group Architects is $289,069.65.*
>
> *The lowest bidder for the project is Greater Dayton Construction. Their total Base Bid minus Alternate Deducts 1-6 for the project is $229,123 and is within the 80% threshold of the estimate probable cost...."*[26]

Clearly, the Authority analyzed and contemplated the price variance. It reasonably determined that the variance was within 80% of the estimated cost and therefore did not constitute a significant variance. It also, through its bid tabulations and Board Memorandum clearly contemplated and demonstrated cost reasonableness. Therefore, any Recommendation, including Recommendation 1C, relating to a price variance notation for Contract 1702 should be reversed or deleted in its entirety.

Contract 1724 – UFAS Conversion

Once again, the Authority used the sealed bid method of procurement. Therefore, it was not required to notate any significant variance between the cost estimate and contract price. Additionally, the Authority reasonably consider the variance to be insignificant. Nonetheless, the procurement files contains a notation related to the price variance.

The Authority estimated the cost of Contract 1724 to be $1,219,409. The four proposals ranged from $888,481 to $949,000. Therefore, the ultimate contract price was less than the cost estimate. The following table illustrates the bids received:

Item	Amount	% Difference to next closest item
Proposal 4	$949,000	1%
Proposal 3	$937,500	3%
Proposal 2	$909,293	2%
Awardee	$888,481	

It's clear from a comparison of the quotes, that the ultimate contract price was reasonable. Additionally, the procurement file contains a Board of Housing Commissioners Memorandum dated August 20, 2014 which states:

[26] *Authority Board of Housing Commissioners Memorandum, August 21, 2013. Previously provided in March and June, 2016.*

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Comment 12

Comment 9

Comment 12

Comments 3, 11, and 12

Comment 9

Comments 12 and 10

"The bids received varied greatly when compared to the probable cost identified by Oregon Group Architects. However, the bids received must be reflective of the true cost of the work of the project and the competitive bidding environment.

Per HUD Handbook 7460.08 REV 2., 10.3B, there are alternative methods of determining that a price is reasonable other than cost analysis. A comparison of the proposed prices received in response to the solicitation to each other is generally sufficient to establish price reasonableness, assuming a sufficient number of competitive offers are received to constitute competitive pricing from the marketplace. The average proposed price of the four bids received on August 7, 2014 is $921,013.75.

The lowest base bid of $888,481 from Pack's Inc. is within the 80% threshold of the average proposed solicitation price received. The price received from Pack's Inc. is fair and reasonable as related to the other bids received."[27]

Clearly the Authority not only considered the price variance between the cost estimate and the bids received, it provided an analysis of how it determined price reasonableness in light of the variance. The Authority reasonably determined that the comparison of the quotes to one another demonstrated price reasonableness. Therefore, HUD any Recommendation that relates to or will related to the estimate/price variance of Contract 1724 should be reversed or deleted in its entirety.

Determination #2 Conclusion

The Draft Audit misapplies the HUD Procurement Handbook 10.3 (E). First, 10.3 application is limited to purchases above the small purchase threshold. Two of the five contracts were below the small purchase threshold. Second, the requirement in 10.3(E) applies exclusively to competitive proposals. Not one of the five contracts in question used competitive proposals. Third, the Draft Audit applies an arbitrary 10% threshold when determining what constitutes a significant variance between the cost estimate and contract price. Fourth, all of the contracts had adequate competition and, in each contract, price reasonableness was demonstrated in the proposals and bid tabulations. Fifth, four of the procurement files contain a memorandum that notates the price variances.

Finally, we must examine the purpose and intent of the requirements. The purpose of these requirements is to ensure that adequate competition exists and that the prices paid for contracts are reasonable. In each of these contracts, adequate competition existed and the Authority demonstrated price reasonableness in each and every instance. It followed the HUD

[27] *Authority Board of Housing Commissioners Memorandum, August 20, 2014. Previously provided in March and June, 2016.*

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requirements and its own policies and procedures. Most of all, it carried out the intent of the requirements and ensured adequate completion existed and that all costs paid were reasonable.

A finding based upon a lack of notation when the housing authority clearly has demonstrated that the contract prices are reasonable is nonsensical and clearly not the intent behind the regulations. Therefore, we respectfully request that the OIG strike any determination or finding based upon a price variance notation.

Comment 14

VI. RESPONSE TO DRAFT AUDIT DETERMINATION #3

The Authority Properly Estimated the Costs Associated with its Contract Modifications.

OIG Issue: The Draft Audit includes a determination that the Authority failed to estimate the cost of additional items for Contracts 1697, 1702, and 1724. It asserts that the Authority was required to provide a written independent cost estimate for each of the additional items contained the contract modifications/change orders relating to the contracts. It bases its assertion on HUD regulations. Specifically the Draft Audit states:

> *"..however, it did not estimate the costs of the items as required by 24 CFR.36(f)(1) and its own procurement policy."*[28]

Legal Analysis: Once again, it appears as if the Draft Audit is erroneously using the term "cost estimate" interchangeably with "cost analysis." The HUD regulations and Procurement Handbook requires a HA to perform a cost analysis for each contract modification/change order, it does not require a separate independent cost estimate. 24 CFR 85.36(f)(1) states:

> *"A **cost analysis** will be necessary when adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders, unless price reasonableness can be established on the basis of a catalog price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulations."*

A cost analysis is an evaluation of the separate elements that make up a contractor's total cost proposal or price to determine if they are allowable, directly related to the requirement, and reasonable.[29]

[28] *Draft Audit Report Page 5-6*
[29] *HUD Procurement Handbook Page 10-15, 10.3(A)(2)*

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Comment 14

The overall purpose of the cost analysis is to settle on total prices that are fair and reasonable.[30] The level of complexity should be commensurate with the dollar value and complexity of the contract.[31]

Chapter 11 of the Procurement Handbook contains HUD's guidance regarding contract modifications/change orders. 11.4(B)(4) sets forth the specific requirements of a change order:

> *"Change orders/modifications should include at least the following: a detailed description of the proposed change in work, a reference to the applicable working drawings and specifications, when applicable, a price (credit, debit, or no change) for the change in contract work, estimate of additional time, if any, required to complete the work, the contractor's itemized breakdown of the cost of materials and labor and an itemized breakdown for any applicable subcontractors, and the change indicate on the architectural or engineering drawings, if applicable."*

Missing is a requirement for the contract modification/change order to contain an independent cost estimate. If HUD intended to require a contract modification/change order to include cost estimate, it would have specified it in 11.4(B)(4).

Additionally, 11.4(D) states that a HA should include, in the contract files, the number of contract modifications/change orders, a brief description of the change, the cost of the proposed change, the action taken and any additional time needed. Again, there is no stated requirement that the contract file contain an independent cost estimate of each contract modification/change order. If HUD intended to have this requirement, it would have stated so in 11.4(D).

Neither section of the Procurement Handbook nor the HUD regulations relating to contract modifications/change orders refer to a requirement to prepare a cost estimate. Instead, the regulation states that a HA must conduct a **cost analysis**.

In each of the three contracts at issue (1697, 1702, 1724), the Authority appropriately prepared the cost analysis when necessary. All of the procurement files contain all items required under Chapter 11 and the Audit Report does not indicate otherwise.

Contract 1697 – Two Change Orders: $1,500 and $445

With regard to Contract 1697, the Draft Audit Report states:

> *"Therefore, on December 9, 2013, it issued a purchase order for $1,945 ($1,500 + $445). However, it did not estimate the cost of additional items to ensure the prices paid were reasonable."*

[30] *HUD Procurement Handbook Page 10-17, 10.3(D)(1)*
[31] *HUD Procurement Handbook Page 10-17, 10.3(D)(2)*

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There were two change orders. The first change order included seven back flows/pressure regulators for a cost of $100 each and for seven new expansion tanks at $50 each. The second change order was for a pump for a cost of $445.

The Authority was not required to prepare a cost estimate prior to the change order. Additionally, the cost analysis requirements are contained in Section 10.3 of the Procurement Handbook. This Contract was a small purchase, therefore, all the formal requirements of the cost analysis contained in 10.3 do not apply. However, the Authority did perform a price analysis to ensure that the prices paid were reasonable. It compared the change order prices to the proposed costs in the contract, which is allowable under 10.3(c) (5).[32]

3. UNIT PRICES:

Contractor to complete Unit Cost Sheet. These prices will be used to calculate costs for any Change Change Orders, etc., increases or decreases in Contract Amount.

Owner may also use unit costs if unforeseen conditions are encountered during construction, making certain changes necessary, or if the Owner desires to order additional Work or delete part of the Work as shown. Unit Costs will be reviewed closely and can be a determining factor in awarding the contract. Contractor shall submit complete list of all unit prices (which may effect his work in any way) with this proposal. All unit prices shall include Contractor's overhead and profit. Prices should include all accessories, coordination and ancillary work necessary for a complete installation.

Item	Description	Unit	Labor	Materials	Total
1.	Installation of circulation pump		$	$	$
2.	Installation of expansion tanks		$	$	$

Figure 4

In the Authority bid documents, the contractors were required to provide prices for the pump and expansion tanks *(Figure 4)*.

Additionally, each contractor was required to provide an alternate deduct that contained the cost of expansion tanks and pumps *(Figure 5)*.

Alternate No # 7 Deduct the installation of new circulating pump from building 5

		Figures	Words
DEDUCT	Labor	$	$
	Material	$	$
	Total	$	$

Alternate No # 8 Deduct the installation the expansion tank in building 4

		Figures	Words
DEDUCT	Labor	$	$
	Material	$	$
	Total	$	$

Figure 5

In September, 2013, the Contractor notified the Authority about the need for the expansion tanks and backflow preventers. The Contractor proposed a cost of $1,500.[33] The Authority, determined the price was reasonable based upon the cost estimates already detailed within the bid documents and based upon industry standards which is acceptable in lieu of a formal cost analysis. A comparison of proposed prices received in response to the solicitation is generally sufficient to establish price reasonableness, assuming a sufficient number of proposals have been received. Here, the bid

[32] **Procurement Handbook Page 10-16**, *10.3(c)(5) When there is a contract modification. When negotiating a modification to any contract (even if the basic contract was awarded competitively through sealed bidding) that changes the scope of work previously authorized and impacts the price or estimated cost, the PHA must use cost analysis to arrive at a reasonable cost.* ***The only exception to this rule is a contract modification based on pricing terms already established in the contract document,*** *e.g., exercising an option to buy additional items at preset prices. It is important to note that changes in a contract's scope do not always result in increased costs. Elimination or reduction of contract work may result in a decrease in the contract price. Regardless of the direction of the price change, these modifications require cost analysis using the cost principles to determine that the price change is fair and reasonable.*

[33] *Emails previously provided June, 2016*

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documents contained line items for the expansion tanks and pump. The cost of each Change Order item was less than the quoted amount within the bid documents. For the backflow preventers, the $700 seemed reasonable in comparison with the work that was being done and based upon the experience of the Authority's contract administrator. Therefore, any Recommendation related to the Change Order price reasonableness for Contract 1697 should be reversed or deleted in its entirety.

Contract 1702 – One Change Order for $8,000

With regard to Contract 1702, the Draft Audit Report states:

> *"the Authority added three items totaling $8,000 to the scope of work through a change order, dated October 14, 2013. Although the Authority used the allowance for bad soil that was part of its initial contract to pay for the items, it did not estimate the cost for each of these additional items to ensure that the price was reasonable."*

Comment 17

The change order for Contract 1702 was for three items which included landscaping and soils stabilization at two sites. The Change Order cost was $8,000. The Contractor submitted an itemized breakdown of the Change Order costs. The project Architect provided the Authority with a Change Order Cost Certification certifying that the costs were reasonable based upon industry standards *(Figure 6)*.

CHANGE ORDER # 1 COST CERTIFICATION

This is to certify that the Cost/Price Analysis for Change Order #1 for the following work: Various soils stabilization at Winston Woods, Rellefontaine and Pompano.

Change Order #1: $8,000.00

( ) Unit Price
( ) Previous Bids
(X) Reference Manual Estimates (Industry Standards)
( ) Others:

A. VERIFIED BY:

(X) Architect ( ) Contractor (X) GDPM Staff ( ) Agreed Cost/Price Analysis

CERTIFIED BY:

ARCHITECT / CONSULTANT
By:
Title: Project Manager
Date: October14, 2013

The proposed cost has been found to be: (X) Acceptable ( ) Not Acceptable

APPROVED FOR GDPM:

By:

Figure 6

The costs were allowable and directly related to the contract. Additionally, the cost certification indicates that the price was reasonable. When conducting a cost analysis, a HA may evaluate the assessment of a proposed Change Order by a technical expert such as an architect.[34]

Here, the Authority, in conformity with HUD guidance, relied upon the assessment of the architect. Additionally, a price reasonableness determination based upon industry norms negates the requirement to conduct a full formal cost analysis.

[34] *HUD Procurement Handbook Page 10-18, 10.3(D)(3)(a)(iii)*

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In March, 2016, the Authority requested, after a request from the Auditor, that the Architect provide a memorandum that included the "industry standard" he was referring to in the Change Order Cost Certification. He provided a detailed analysis comparing each element to the applicable RS Means.[35]

The Authority was not required to prepare an independent cost estimate for the Contract 1702 Change Order. The Authority appropriately prepared a cost analysis and determined the Change Order costs were reasonable. Therefore, any recommendations related to the Contract 1702 Change Order, including Recommendations 1C and 1D, should be reversed or deleted in its entirety.

Contract 1724 – 8 Change Orders

Once again, the Draft Audit indicates that the Authority improperly processed its Contract Change Orders because the procurement file did not contain independent cost estimates for the work items included in the Change Orders dated from December 14, 2014 through November 16, 2015.

The Draft Audit states:

"The Authority added 16 work items totaling $231,569 to the scope of work through eight change orders, dated from December 14, 2014 through November 16, 2015. For these additions, it did not estimate the related costs as required. ***The Authority's procurement file contained a cost certification for each change order in which its architect certifies that the proposed costs were acceptable based on reference manual estimates."***

We agree with the Draft Audit in that the Contract 1724 Procurement File contains a cost certification for each Change Order in which the Authority's third party architect certified that the costs were reasonable based upon reference manual estimates. Because the Authority is only required to perform a cost analysis and the Draft Audit concluded that the procurement files contain the documentation of analysis, the Authority has fulfilled its obligation under the HUD regulations and Procurement Handbook. Additionally, the Authority provided the OIG with a detailed memorandum from the Architect that does a side by side comparison of the applicable RS Means costs compared to the Change Order costs. Therefore, any Recommendation based upon the Change Orders for Contract 1724, including Recommendation 1D and 1E should be reversed or deleted in its entirety.

Determination #3 Conclusion

The Draft Audit bases its determination #3 on an erroneous misinterpretation of the HUD regulations and HUD Handbook. The Draft Audit indicates that the determination is based upon the Housing Authority not providing cost estimates of the Change Orders for three contracts. However, the housing authority fulfilled its regulatory obligations by performing the cost/price analysis in each instance and provided the documentation demonstrating this to the OIG. And, the Draft Audit does not indicate otherwise. Its determination is based exclusively upon the procurement files not

[35] *Previously provided in March and June, 2016.*

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containing independent cost estimates for the items included in the Change Orders. Therefore, the Authority requests that all the Draft Audit be revised to delete this determination in its entirety along with all Recommendations related to it.

Remaining Recommendations

The Draft Audit provides a Recommendation that the Authority reclassify $445 in construction costs arising from the Contract 1697 Change Orders to the correct budget line item.[36] The OIG followed-up with the Authority and verbally requested that the total Change Order amount of $1,995 by reclassified from BLI 1430 to BLI 1460. The Authority agrees that the items should have been charged to BLI 1460 and it's revised its General Ledger to reflect this. However, the grants have since been closed and it's the Authority's understanding that it is no longer able to change the line items in LOCCS.

The Draft Audit also recommends that the Authority implement adequate procedures and controls to ensure that the proper documentation is maintained and contracts are procured and administered in accordance with HUD's and the Authority's procurement requirements. The Authority updated its Procurement Policy in September, 2015. Additionally, the Authority utilizes a more detailed cost/price analysis form that will be used with all contract including small purchases and is including, with the cost estimates, additional documentation to support the cost estimates.

VII. CONCLUSION

The Authority Generally Complies with HUD's and its Own Procurement Requirements.

As indicated and demonstrated throughout this response, the Draft Audit contains one Finding based upon several erroneous applications and misstatements of the HUD regulations and the Procurement Handbook. The Finding is based upon three determinations, but it is evident that the determinations are not accurate.

Throughout the report, the Draft Audit uses cost estimate and cost analysis interchangeably. These are two separate and distinct items with separate requirements. Recommendations 1A, 1D, and 1E, are based upon inaccurately using cost estimate and cost analysis interchangeably. The Draft Audit asserts that an independent cost estimate was required for each Contract Modification. It is clear from the regulations, and Chapters 10 and 11 of the Procurement Handbook that a cost estimate was not required. Additionally, Recommendation 1A, as it refers to Contract 1707, is also based upon the Draft Audit erroneously applying the cost analysis requirements to cost estimates.

With respect to Determination #2, the Draft Audit erroneously applied the last sentence of HUD Procurement Handbook 10.3(E) to all five Contracts. However, it is clear from the plain language of 10.3(E) and from the HUD Sample Procurement Policy, that the requirement to provide a price variance notation applies exclusively to competitive proposals. Not one contract at issue was procured with a competitive proposal. Additionally, 10.3 expressly does not apply to small

[36] *Draft Audit Recommendation 1F*

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Comment 20	purchases (Contracts 1697 and 1707). Since two of the contracts at issue are small purchases and all other contracts at issue were procured via sealed bids, Recommendations 1B and 1C are not supported and should be deleted. Recommendation 1A, with respect to Contract 1697, is based upon the Draft Audit's inaccurate conclusion that the Authority was required to provide an independent cost estimate for each alternate deduct. Therefore, Recommendation 1A should be deleted in its entirety. In each and every procurement action in question, the Authority's procurement files have contained the documentation necessary to demonstrate adequate competition and price reasonableness. In most cases, the Authority went above and beyond the HUD requirements. Each file contains a thorough, concise price/cost reasonableness analysis. Therefore, recommendations 1A through 1E are not supported and determinations 1 through 3 are unfounded. Based upon the foregoing, the Authority respectfully requests the OIG to withdraw its Finding and revise the Draft Audit Report and state "the Authority Generally Follows HUD's and its Owe Procurement Requirements." Respectfully Submitted, Jennifer N. Heapy Chief Executive Officer Dayton Metropolitan Housing Authority 937-910-7622 jheapy@dmha.org 23 *August 29, 2016* *OIG Audit Response*

OIG Evaluation of Auditee Comments

Comment 1 The Authority contends that the scope of the audit was more expansive than a review of the Authority's procurement practices. Generally Accepted Government Auditing Standards requires us to obtain a sufficient understanding of an entity's control environment. The survey objective was to determine whether the Authority administered its program in accordance with HUD's and its own requirements. During the survey phase, we performed limited testing of various aspects of the Authority's public housing program to identify area(s) of high risk to focus on during the audit. In this case, our limited testing identified that the Authority's procurement transactions yielded a high risk. Therefore during the audit phase, we focused our review on the Authority's procurement practices and performed more detailed testing to support our conclusions.

Comment 2 The Authority contends that the audit report failed to identify relevant procurement policies of the Authority. It also contends that it fully followed HUD's and its own procurement policy. Appendix C of the audit report, cites applicable excerpts from HUD's and the Authority's procurement requirements. The report acknowledged that the Authority prepared independent costs estimates; however, the estimates were not adequate. The report also stated that the Authority did not justify the reasonableness of the prices paid by failing to conduct cost analyses in accordance with Federal requirements and lacked adequate documentation to properly support its procurements.

Comment 3 The Authority contends that it did not use competitive proposals as a method of solicitation of bids for contract number 1697. We removed the statement regarding the Authority's use of competitive proposals for contract 1697 from the report and modified the report accordingly.

Comment 4 The Authority states that the report's contention that its written cost estimates for contract 1697 and 1707 did not have enough detail was predicated on misinterpretations and misapplications of HUD's procurement requirements. We disagree. HUD Handbook 7460.8 REV-2, states that an estimate must be prepared prior to obtaining offers. The degree of analysis will depend on the size and complexity of the purchase. As mentioned in the audit report, the Authority's independent estimates only stated the total cost of the scopes of work. It did not provide any other details such as quantity of materials, labor, etc. For contract 1697, the Authority accepted alternate number 13; however, the estimate did not contain any information regarding alternates. Therefore, it did not have an independent estimate for the services performed.

Comment 5 The Authority contends that it determined price reasonableness by comparing the three proposed prices received. Paragraph 5.5(A)2 of HUD Handbook 7460.8 REV-2, states that before making an award, the contracting officer must determine that the proposed price was fair and reasonable. For most small

purchases, a price analysis would be sufficient to make that determination. In addition, for small purchases above the micro purchase threshold, generally, a price analysis would consist of a comparison of quotations to each other *and* to other sources of pricing information (e.g., past prices paid, catalog prices, etc.). Further, an analysis was needed because there was a greater than 10 percent difference between the Authority's independent estimate and the lowest winning bid. Specifically, for contract number 1697, the lowest bid for the initial cost of scope of work exceeded the Authority's cost estimate by more than 50 percent.

Comment 6 The Authority contends that the draft report seems to erroneously use these terms interchangeably. We clarified the audit report to better differentiate between cost estimates and cost analyses.

Comment 7 The Authority contends that the requirement to prepare an individual cost analysis did not apply to construction contracts that were procured using sealed bids. We disagree. The report stated that the Authority did not justify or explain the significant difference between the independent cost estimate and the price obtained. Paragraph 10-3(e) HUD's Handbook 7460.8, REV-2, and HUD's Quick Guide to Cost and Price Analysis for HUD Grantees and Funding Recipients states that for sealed bids method of procurement, a cost analysis must be performed (1) when there was not sufficient competition, (2) if after soliciting competitive sealed bids, only one bid is received, or (3) bids received differs substantially from the independent estimate of the contract price.

Comment 8 The Authority contends that for contract 1707, it obtained a sufficient number of bids to demonstrate that the contract was awarded competitively and after a comparison of the bids it was apparent that the costs were reasonable. As stated in the audit report, the lowest bid for the contract was 30 percent less than the estimate. Therefore, the Authority should have performed a cost analysis as required by HUD.

Comment 9 The Authority contends that the draft report arbitrarily concludes that a 10 percent difference between the cost estimate and contract award equates to a significant price variance and therefore, triggers an additional requirement that the Authority include a price variance notation in the procurement file. We disagree. The 10 percent significant variance between the independent cost estimate and contract award had been determined by HUD. We acknowledge that HUD's handbook does not define significant difference. However, the Authority should have consulted with HUD for clarification.

Comment 10 The Authority contends that the requirement to notate the file applied to competitive proposals only and therefore did not apply to any of the five (1697, 1698, 1702, 1707, and 1724) contracts. However, the files contained a notation. The report stated that the Authority's procurement files did not contain sufficient documentation to justify or explain the significant difference between the

independent cost estimate and the price obtained. Handbook 7460.8, REV-2, paragraph 10.3(e) states that documentation is required to demonstrate price reasonableness, including any cost analyses, whenever the price obtained varied significantly from the independent cost estimate, in which case the contracting officer should notate/explain the reasons for the difference, e.g., poor estimate, etc. For the Authority's procurements, the independent cost estimate for four contracts using sealed bid procedures, significantly varied from the contract price. The Authority's procurement files for the four contracts contained a notation regarding the difference between the independent cost estimates and the bids received. However, the notation did not explain or justify the significant difference between the independent cost estimate and the lowest bids received. In addition, see comment 3 regarding the removal of contract 1697; thus the number of contracts cited was reduced from five to four.

Comment 11 The Authority contends that paragraph 10-3(e) of HUD's procurement handbook did not apply to contract 1707. Contract 1707 was purchased using the sealed bids method of procurement because the Authority's independent cost estimate, assessed the cost would exceed $120,000.

Comment 12 The Authority contends that since all five contracts (1697, 1698, 1702, 1707, and (1724) had sufficient competition and a comparison of the proposed prices demonstrated price reasonableness. All five contracts had significant variances between the independent cost estimate and the lowest bid as detailed in the report. Therefore, the Authority should have performed a price or cost analysis in accordance with HUD Handbook 7460.8, REV-2 and HUD's quick guide. In addition, see comment 3 regarding the removal of contract 1697; thus the number of contracts cited was reduced from five to four.

Comment 13 The Authority contends that the calculation of the price variance for contract number 1702 in the audit report was inaccurate because the auditor included an $8,000 bad soil allowance in the contract amount that was not included in the cost estimate. The Authority provided two cost estimates for contract number 1702, one dated July 11, 2013, in the amount of $185,047 that did not include the bad soil allowance of $8,000 and one dated July 12, 2013, in the amount of $194,195 that did include the $8,000 bad soil allowance. We used the $194,195 to calculate the percentage. Therefore, the Authority's independent cost estimate exceeded the contract price by nearly 18 percent (($229,123 - $194,195)/$194,195). Therefore, the Authority should have justified the price difference as required by HUD's procurement handbook and quick guide.

Comment 14 The Authority contends that the report includes a determination that the Authority failed to estimate the cost of additional items for three contracts. We revised the wording in the report from estimate to analyze. For three of the Authority's contracts (contract numbers 1697, 1702, and 1724), it included additional items that were not part of the original scope of work; however, it did not *analyze* the

cost of the items as required by 24 CFR 85.36(f)(1) and its own procurement policy, which was cited in the draft report.

Comment 15 The Authority contends that because contract number 1697 was purchased through the small purchase method of procurement, the requirement for a cost analysis do not apply. Regulations at 24 CFR 85.36(f)(1) state that grantees and subgrantees must perform a cost or price analysis in connection with every procurement action, including contract modifications.

Comment 16 The Authority states that it performed a cost analysis to ensure that the prices paid were reasonable for the contract modifications under contract 1697 by comparing the change order prices to the proposed costs in the contract. The Authority did not prepare an independent estimate for the awarded original scope of work; therefore, reasonableness of the awarded proposed contract modifications could not be determined.

Comment 17 The Authority states that its architect prepared cost certifications certifying that the costs of the contract modifications for contracts 1702 and 1724 were reasonable based on industry standards. Further, the Authority states that the architect provided detailed analyses comparing each element to the applicable RS Means. We acknowledge that the Authority's architect prepared cost certifications, and as a result of our audit, analyses using RS Means. However, the Authority did not provide documentation to support the RS Means determinations.

Comment 18 The Authority states that its understanding was that it cannot change the line items in HUD's system for the $1,995 charged to the wrong budget line item under contract number 1697. We revised recommendation 1F to state the following:

- Reimburse the U. S. Treasury from its capital fund account $1,945 charged to the incorrect budget line item in HUD's system.

Comment 19 The Authority contends that it updated its policy in September 2015 and will use a more detailed cost/price analysis form for all of its contracts. We commend the Authority for updating its procurement policy. The Authority should work with HUD to ensure that its updated policy addresses the deficiencies cited in this report.

Comment 20 The Authority contends that the OIG should withdraw its finding and revise the draft report to state that the Authority generally followed HUD's and its own procurement requirement. We disagree. As stated in the audit report, the Authority did not always comply with HUD's and its own procurement policies. Specifically, it did not always (1) prepare adequate independent cost estimates, (2) maintain documentation to justify and explain the difference between the independent cost estimates and contract price, and (3) analyze or examine the cost

of the additional items included in the scope of work. The only changes made to the report are noted in these comments.

Appendix C

HUD and Authority Requirements

Regulations at 24 CFR 85.36(f)(1) state that grantees and subgrantees must perform a cost or price analysis in connection with every procurement action, including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, grantees must make an independent cost estimate before receiving bids or proposals. A cost analysis must be performed when the offeror is required to submit the elements of his estimated cost. A cost analysis is necessary when adequate price competition is lacking and for sole-source procurements, including contract modifications or change orders, unless price reasonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulations. A price analysis will be used in all other instances to determine the reasonableness of the proposed contract price.

Paragraph 3-3(A) of HUD's procurement handbook states that the public housing agency must maintain records sufficient to detail the significant history of each procurement action.

Paragraph 10-3(E) states that documentation is required to demonstrate price reasonableness, including any cost analysis, whenever the price obtained varies significantly from the independent cost estimate, in which case the contracting officer should notate or explain the reasons for the difference; for example, poor estimate, etc.

HUD's Quick Guide to Cost and Price Analysis for HUD Grantees and Funding Recipients states that for sealed bids method of procurement, normally, the competitive pricing forces of the marketplace determine the reasonableness of the low price obtained through sealed bidding. Nevertheless, the housing authority should always compare its own independent cost estimate to the low competitive bid received. In the event they are significantly different, the housing authority will need to examine each to verify that either its own estimate or the market price is valid.

Paragraph 7-9 of HUD's Office of Public and Indian Housing Capital Fund Guidebook states that in HUD's system Public Housing Authority's may not draw down funds from one budget line item for expenditures associated with another budget line item. If an Authority disburses funds from the wrong budget line item, HUD's Public and Indian Housing Field Office will direct the Authority to immediately transfer those funds back to the U.S. Treasury, and the funds will be credited back to the budget line item from which the funds were incorrectly withdrawn.

The Authority's procurement policy states that for all purchases above the micro purchase threshold, the Authority must prepare an independent cost estimate before solicitation. The level of detail must be appropriate with the cost and complexity of the item to be purchased. For small purchases, a comparison with other offers and an independent cost estimate will be sufficient to determine price reasonableness. For sealed bids, the presence of adequate competition and an independent cost estimate will be sufficient to establish price reasonableness. However, where sufficient bids are not received, and when the bid received is substantially more than the

independent cost estimate, and where the Authority cannot reasonably determine price reasonableness, the Authority must conduct a cost analysis, consistent with Federal guidelines, to ensure that the price paid is reasonable. For contract modifications, a cost analysis, consistent with Federal guidelines, must be conducted for all contract modifications for projects that were procured through sealed bids.