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TO: Raphael Mecham, Administrator, Southwest Office of Native American Programs, 9EPI

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Navajo Housing Authority Should Discontinue Its Use of Subgrantees for Development Projects or Implement Additional Program Controls

HIGHLIGHTS

What We Audited and Why

We audited the Navajo Housing Authority's (Authority) use of subgrantees for housing development projects after staff from HUD's Southwest Office of Native American Programs notified the Office of Inspector General (OIG) of its concerns about apparent abuses in the use of Native American Housing and Self-Determination Act (NAHASDA) grant funds by a particular Authority subgrantee. The objective of the audit was to determine whether the Authority's procedures for selecting and monitoring subgrantees were adequate to ensure compliance with NAHASDA program requirements.

What We Found

The Authority's procedures for selecting and monitoring subgrantees did not ensure that NAHASDA grant funds were used in accordance with applicable program requirements and that performance goals were achieved. As a result of these weaknesses, the Authority failed to prevent recurring problems, including extended project delays, excessive project expenses, and misuse of NAHASDA grant funds by subgrantees and/or their construction contractors. The ultimate result of these failures was significantly fewer housing opportunities for the intended program beneficiaries, Navajo citizens. This occurred because the Authority failed to design and implement adequate controls over its processes for selecting subgrantees and monitoring subgrantee construction and management activities.

What We Recommend

We recommend that HUD's administrator for the Southwest Office of Native American Programs require the Authority to 1) consider discontinuing the use of subgrantees for housing development activities and establish a new strategy for more efficient and effective housing development or 2) implement additional controls to ensure that funds provided to subgrantees are used in accordance with NAHASDA requirements and in a manner that will ensure performance and management goals are achieved.

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

Auditee's Response

We provided the Authority a draft audit report on February 12, 2007, and held an exit conference to discuss the report on March 2, 2007. The Authority provided written comments on March 8, 2007. It generally agreed with the overall report conclusions, but did express concerns with some of OIG's report statements. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Under the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. [*United States Code*] 4101 et seq.) (NAHASDA), the U.S. Department of Housing and Urban Development (HUD) provides grants, loan guarantees, and technical assistance to Indian tribes and Alaskan Native villages for the development and operation of low-income housing in Indian areas. Annual grants are made in the form of Indian Housing Block Grants that allow tribes to design, implement, and administer their own housing programs. Indian Housing Block Grants allocated to each tribe are determined based upon a formula calculation.

The Navajo Housing Authority (Authority) is the tribally designated housing entity for the Navajo Nation and, thus, administers funding received by the tribe under NAHASDA. The Authority is responsible for compliance with NAHASDA and its implementing regulations and ensuring compliance by subgrantees. In general, subgrantees must comply with the same statutory and regulatory requirements as Indian Housing Block Grant recipients.

The Authority has received an average of approximately $89 million in Indian Housing Block Grant funding annually. It has used up to 50 percent of its annual NAHASDA funding for activities administered by independent subgrantees; however, in recent years (fiscal years 2005 and 2006), the amount used for independent subgrantee activities has been limited to approximately 25 percent of the annual NAHASDA funding received.

According to the Indian housing plans for years 2003 through 2006, submitted to HUD through the Authority, approximately 23,000 low-income families living on the reservation were living in substandard housing, and 15,000 low-income families were living in overcrowded conditions.

In August 2000, the Authority created a new Grants Management Division to monitor its housing development activities. Currently this division provides oversight of all subgrant activities for the Authority, including funding proposal evaluations, monitoring reviews, and reviewing payment requisitions. The Grants Management Division is also responsible for providing technical assistance to subgrantees.

The objective of the audit was to determine whether the Authority's procedures for selecting and monitoring subgrantees were adequate to ensure compliance with NAHASDA program requirements. The audit was performed after staff from HUD's Southwest Office of Native American Programs notified the Office of Inspector General (OIG) of its concerns about apparent abuses in the use of Native American Housing and Self-Determination Act (NAHASDA) grant funds by a particular Authority subgrantee.

RESULTS OF AUDIT

Finding 1: The Authority's Procedures for Selecting and Monitoring Subgrantees Were Not Adequate

The Authority's procedures for selecting and monitoring subgrantees failed to ensure that NAHASDA funds were used in accordance with program requirements and that housing production goals were achieved. As a result, the Authority failed to prevent recurring problems, including extended project delays, unnecessary project expenses, and misuse of NAHASDA grant funds by subgrantees and/or their construction contractors. These failures resulted in increased costs, inefficient housing production, and, ultimately, significantly fewer housing opportunities for the intended program beneficiaries, Navajo citizens. In this regard, we identified at least 14 housing projects, for which more than $53 million has already been allocated, yet the projects were either not started or not finished, funds were misused by subgrantees and/or their contractors, or construction or management problems threaten the long-term viability of the housing projects. These problems were caused by the Authority's failure to implement adequate controls over the process for initially selecting subgrantees to ensure that they had the capacity to effectively administer the funded activities and failure to implement adequate controls to monitor subgrantee activities to ensure that the entities complied with NAHASDA requirements and completed their projects as planned.

NAHASDA Requires Effective Program Controls

One of the primary objectives of NAHASDA is to assist and promote affordable housing activities, including the development, maintenance, and operation of affordable housing in safe and healthy environments for occupancy by low-income Indian families. To achieve this objective, NAHASDA regulations require that recipients have internal controls necessary to administer the activities effectively without fraud, waste, or mismanagement. The regulations also require that recipients of NAHASDA funds monitor their grants and subgrant-supported activities to ensure compliance with applicable federal requirements and that performance goals are being achieved. Office of Management and Budget Circular A-87 also requires that NAHASDA award recipients employ whatever form of organization and sound management practices that are necessary to ensure efficient and effective administration of the funds.

The Authority Did Not Implement Adequate Controls over Its Subgrant Activities

The Authority did not implement adequate controls over its subgrant activities as required. It failed to implement adequate controls over its process for selecting subgrantees, including ensuring that they had the capacity to effectively administer the construction and ongoing management of the proposed projects, funding was consistent based upon the housing needs for each geographical area within its jurisdiction, and proposed housing development costs were reasonable and supported. The Authority also failed to adequately monitor subgrantee activities to ensure that the entities complied with specific NAHASDA program requirements for construction activities.

The Authority Did Not Ensure That Subgrantees Had the Capacity to Effectively Administer Projects

As part of its subgrant proposal evaluation process, the Authority failed to ensure that its subgrantees had sufficient capacity to administer the proposed construction and postconstruction project management activities. For example, many of the Authority's subgrantees did not have prior experience or knowledge related to housing development. These subgrantees did not have specific plans or the capacity to oversee the work of construction contractors or the capacity to detect and prevent potential contractor improprieties. Many of the Authority's subgrantees were not familiar with NAHASDA program requirements, including those related to procurement, insurance and construction bonding, and necessary elements for soliciting and managing construction contracts.

The Authority also did not evaluate potential subgrantees' capacity to administer force account construction activities when this was proposed and did not adequately review potential subgrantees' capacity or plans to ensure that completed housing units would be properly managed after construction completion. For example, the Authority did not evaluate subgrantees' plans for ensuring that completed housing units would be covered by insurance or that the intended housing management agent or residents were capable of ensuring that the units would be adequately maintained. Since NAHASDA-funded houses in some cases were transferred to very low-income, elderly, or disabled individuals, they may not be able to afford insurance or properly care for the units, and the Authority did not ensure that the subgrantee (or the Authority itself) had plans to address these concerns. For rental projects, the Authority did not ensure that subgrantees had appropriate plans for establishing reserve accounts to allow for repair or replacement of high-cost items. Without appropriate plans in place to ensure that housing units are properly insured and maintained, the useful life of the housing could be significantly reduced. Further, problems arising from a lack of appropriate planning for protection of completed units could affect future requests for NAHASDA funding for repair or replacement costs, and additional management funding for subgrantee units would reduce the availability of funding for new units. The Authority's failure to ensure proper planning for completed housing units could reduce the number of families assisted and significantly limit the long-term effectiveness of the Authority's housing program.

Based upon the Authority's most recently prepared summary of subgrantee monitoring review findings, dated May 31, 2005, 11 of 48 (23 percent) subgrantees reviewed by the Authority did not have the capacity to properly administer the grant funds awarded.[1] Further, Authority Grants Management Division quality inspectors responsible for monitoring subgrantees and providing technical support stated that the use of inexperienced subgrantees has consistently caused significant construction delays and in some cases, project failures and misuse of grant funds by contractors. The Office of Inspector General's (OIG) site visits to three Authority subgrantee projects (a nonstatistical sample) found that the subgrantees each lacked some basic qualifications for administering construction projects, including familiarity with NAHASDA program requirements, adequate accounting systems and qualified accounting or bookkeeping personnel, and capacity to oversee construction contractors and/or project managers.

Subgrantees Relied upon Outside Consultants and/or Contractors without Adequate Oversight

In several cases involving inexperienced subgrantees, nearly all aspects of the projects' planning and construction were controlled by outside developers or consultants with little or no oversight by the subgrantees themselves. These arrangements lacked essential controls to ensure that the interests of the project and the NAHASDA program were protected, greatly increasing the risk that funds would be used inefficiently or inappropriately. In some cases, the contractors prepared the funding proposals on behalf of the subgrantees, acted as the general contractor, and even handled aspects of the projects' financing including preparation of draw requests submitted to the Authority. In some cases, it also appears that the contractors did not compete to obtain the contracts for construction of the projects.

[1] As of January, 26, 2007, the Authority did not have an updated report available for our review, summarizing the results of its findings for monitoring reviews performed after May 11, 2005.

Authority managers acknowledged that previous efforts to evaluate the capacity of potential subgrantees were inadequate and stated that they are implementing new procedures to address this problem. However, the potential effectiveness of these proposed new procedures is questionable. For example, the Authority does not require that subgrantees have any prior experience in construction activities, even for proposed multiunit development projects. Also, the revised procedures do not adequately consider several factors that have significantly impacted previously funded projects, including

- The subgrantees' plans for working with a predetermined consultant or contractor,
- The subgrantees' plans to oversee consultants and/or contractors,
- The subgrantees' familiarity with their written policies and procedures and whether they have been implemented,
- The subgrantees' and managements' references and performance on similar projects (not funded by the Authority),
- The subgrantees' capacity to manage completed units,
- The subgrantees' plans for ensuring that completed projects are insured and properly maintained, and
- The adequacy of the subgrantees' primary staff qualifications.

The Authority Did Not Properly Evaluate Housing Needs or Proposed Development Costs

The Authority's subgrantee selection process did not include a required evaluation of the housing needs for each geographical area within its jurisdiction and did not include an evaluation of the reasonableness of subgrantees' proposed housing development costs. The Authority has not performed a recent analysis of housing development costs to assist in determining whether subgrantee-proposed development costs were reasonable or to assist in establishing development cost guidelines. Further, the Authority does not require that potential subgrantees submit project plans or detailed budgets to ensure that projects are not overfunded or underfunded.

The Authority Did Not Adequately Monitor Subgrantee Activities

The Authority did not establish and implement adequate controls to ensure that subgrantees complied with NAHASDA requirements. Such controls are particularly important since, as discussed above, many of the subgrantees selected by the Authority did not have adequate capacity to administer their projects or were under the control of outside construction contractors or consultants. For example,

- The Authority did not have comprehensive written procedures and guidelines for subgrantees and its own staff to allow for consistent and efficient application of policies. The subgrantees we visited stated that they looked to the Authority for guidance in administering their projects and complying with NAHASDA program requirements yet often received inadequate or inconsistent information. As discussed above, the Authority did not ensure that subgrantees were familiar with Authority or NAHASDA requirements before receiving funding for the projects. Authority staff acknowledged that the lack of adequate comprehensive written procedures and guidelines likely contributed to problems encountered on some projects. Authority staff responsible for overseeing ongoing subgrantee projects also indicated that their monitoring duties were often undermined when upper management at the Authority overrode their determinations regarding enforcement activities and they did not have a set of fixed policies upon which they could object and pursue compliance with reasonable standards. The Authority's Grants Management Division initiated an effort to draft written guidelines related to project planning and development for use by Authority staff and subgrantees; however, the guidelines were not completed.

- The Authority did not require subgrantees to submit copies of proposed contracts with general contractors and/or construction managers for review and failed to ensure that subgrantees complied with procurement requirements in obtaining such contracts. We reviewed four subgrantee contracts for construction services (nonstatistical sample). One of the four contracts was a cost-plus type contract, which is prohibited under 24 CFR [*Code of Federal Regulations*] 85.36(f)(4). Two of the four contracts assigned the entire subgrant amount for use by the contractor yet did not include detailed requirements for the projects' design and did not specify the amount of allowable contractor profit. Since project costs could vary significantly based upon variations in the scope of work, without this detail, the Authority has no assurance that the projected costs (contract amounts) are reasonable. Authority staff indicated that projects were often funded for both design and construction phases without any detailed plans for the projects' design or a detailed budget.

  Authority staff indicated that in some cases, the subgrantees had no idea of the actual costs for the project until the third or fourth year after receiving initial funding. These types of "open-ended" contracts do not allow for price competition based upon fixed plans and specifications, and since the subgrantees in many cases have only limited experience or knowledge related to construction activities, there is no effective control mechanism to ensure that the final design and specifications are appropriate given the amount of funds allocated for the project. These types of arrangements, which eliminate price competition and rely upon the ability of inexperienced parties to determine the reasonableness of construction costs, can result in significantly increased risk that costs will exceed the value of the products and services provided or that the funding allocated will not be sufficient to complete the project.

The Authority's monitoring reviews found that 15 of 48 subgrantees reviewed as of May 31, 2005, failed to comply with federal procurement standards. Based upon discussions with Authority staff, in several cases the Authority assumed the risk of subgrantee budget shortfalls and incurred additional expenses because subgrantee contracts with construction managers were "open ended" and did not require accountability for project costs.

- The Authority did not verify the availability of subgrantees' planned match funding. In several cases, subgrantee construction projects were shut down and incurred significant associated costs after the subgrantees' planned match funding failed to materialize. In several other cases, the Authority provided additional NAHASDA funding to avoid failure of the projects.

- The Authority did not implement adequate controls over subgrantee payment requisitions. It did not consistently require subgrantees to use a detailed schedule of values to monitor project budgets and maintain control over contractor payment requisitions. It did not monitor requisitions to ensure that contractors did not shift amounts between budgeted cost categories without approved change orders. It also did not consistently require lien waivers from the contractors and subcontractors before paying draw requests. Partial lien waivers should be checked against the schedule of values to ensure that subcontractors have been paid from previous requisitions and that the work currently claimed as completed is supported by the subcontractor's lien waivers.

- Although Authority staff performed site visits to verify general construction progress before approving construction draw requests, they were not certified inspectors and did not inspect construction work to thoroughly evaluate construction quality, compliance with building codes, or compliance with architectural plans and specifications. The Authority did not require that subgrantee projects be independently inspected during the construction process.

This is a particularly important lapse in controls since no building code inspections were performed by a governing Authority on the Navajo reservation. Accordingly, significant construction flaws could go unnoticed and could materially affect the useful life of the housing.

- The Authority did not have adequate procedures to ensure that appropriate construction contractor bonds or deposits were in place. It did not require subgrantees to submit evidence that bonding or deposit requirements were met. In several cases, bonds were not obtained and contractors hired by subgrantees failed to complete their projects and failed to pay subcontractors after NAHASDA funds were drawn down for this purpose. As a result, funds were not available to complete the projects, and the projects were left with significant debt to unpaid vendors.

- The Authority did not implement controls to ensure that subgrantees obtained required insurance to cover potential damage to the projects during construction. It also did not ensure that subgrantees had appropriate plans for ensuring that the completed projects were insured as required. Some NAHASDA-funded projects were not insured and incurred significant damages. As a result, additional NAHASDA funding was required to repair the damage, or the projects had to be scaled back to cover the repair costs.

- The Authority did not implement adequate procedures to monitor subgrantees' program income (income received from operation of NAHASDA-funded projects). NAHASDA regulations require that such income derived from NAHASDA-funded projects be used for housing-related activities. According to Authority staff, both the Authority and its subgrantees had little understanding of program income and how it should be identified and treated. Accordingly, in many instances there was little, if any, accountability for income received from project operations.

The Authority did not have procedures to ensure that findings identified during its subgrantee monitoring reviews were resolved in a timely manner. It required that subgrantees submit a corrective action plan to address open audit findings, and its policy was to perform a followup visit to verify completion of the corrective actions within 120 days. We reviewed the Authority's actions taken to resolve open findings associated with 23 monitoring reviews and found that the

Authority did not make timely followup visits to ensure that the findings were corrected in eight of the cases (35 percent). In five of the cases (22 percent), the Authority did not perform any followup visit to ensure that the findings were resolved. In several cases, findings remained unresolved for one or more years without adequate followup action by the Authority to resolve the outstanding issues.

Inadequate Controls over the Selection and Monitoring of Subgrantees Impacted Results

The Authority's failure to ensure that subgrantees had sufficient capacity to administer the construction and management of their projects and the failure to adequately monitor subgrantee activities resulted in unnecessary project expenses, significant delays, and in some cases, misuse of NAHASDA grants funds by subgrantees and/or their construction contractors. These problems dramatically reduced the number of potential housing opportunities for Navajo citizens. For example[2],

> One Authority subgrantee received approximately $12 million in NAHASDA funding for development of 90 housing units but was apparently under the control of a developer/consultant with virtually no oversight by the subgrantee. The project was initially funded in 2001, and nearly all of the grant funding has been drawn down. The subgrantee declared bankruptcy, and the project was left with approximately $800,000 in unfinished construction work and approximately $2 million in unpaid vendor claims. While the construction of homes is nearly complete, the site remains vacant, and there is no existing potable water source or access to nearby roads because the subgrantee and its developer apparently did not plan and coordinate with the appropriate authorities to ensure the availability of these services. Another Authority subgrantee received $14.5 million in NAHASDA funding for construction of 121 homes and allowed the same developer to administer the project without adequate oversight. The project was shut down for approximately one year after the subgrantee and its contractor failed to follow NAHASDA requirements and started construction before obtaining the necessary environmental clearances. As a result, the project incurred approximately $550,000 in unnecessary additional costs, and the planned number of units was reduced by 30. It also appears that the project will require at least $2 million in additional funds for completion, even considering the reduced number of units. In this

[2] See Appendix C for the respective funding amounts associated with each of the example projects listed.

case, the subgrantee did not have the capacity to properly oversee the developer and failed to ensure that insurance and bonds were in place. It also appears that this project may have significant construction quality issues, including the use of inferior building materials, poor workmanship, and building code violations (Projects 1 and 2).

- One Authority subgrantee received a total of $1.9 million in 2003 and 2004 for the initial construction phases related to the demolition and reconstruction of 60 housing units. The subgrantee apparently did not have adequate capacity to administer the project and oversee its construction contractor. Work on the project halted after the Authority suspended payments due to apparent questionable expenses, inadequate bookkeeping, concerns over unpaid vendor invoices, and commingling of funds. The involved families were evicted from their homes when construction work started, and there was no plan for their relocation or the hardship costs they faced. The project remains incomplete, and some of the families are apparently homeless as a result of the project's failure (Project 3).

- One Authority subgrantee received approximately $1.7 million in NAHASDA funds and constructed a nursing home facility that was substantially completed in November 2005. However, the facility remains unoccupied because the subgrantee did not have firm commitments for obtaining the funding needed to operate the nursing home. As of February 2007, the center remains unoccupied (indefinitely) as the subgrantee continues its efforts to resolve issues associated with funding for its operations. This subgrantee also received $1.3 million for construction of 20 housing units for elderly individuals. However, after more than two years, the subgrantee has failed to finalize the planning process for these units. The subgrantee hired a consultant to manage the project, but the subgrantee was not familiar with NAHASDA requirements, did not have any prior construction experience, and was not capable of overseeing the consultant. Since the consultant was not retained under a fixed-price contract, she continued to receive compensation from NAHASDA funds even as the project sat idle (Project 4).

- One Authority subgrantee received approximately $3.4 million in NAHASDA funds to construct a shelter for women and children. While almost all of these funds have already been expended, the shelter is only approximately 60 percent completed, and work on the project has halted. Authority staff estimate that the project will require an additional $1.5 million to complete. In this case, it appears that the subgrantee did not have any prior experience in construction and did not have the capacity to oversee a construction project of this size. The subgrantee entered into an open-ended, cost-plus contract for construction and failed to obtain planned match funding (Project 5).

- One Authority subgrantee received $ 2.9 million in NAHASDA funds to construct a shelter. The project was started in 2000 with a projected completion date in 2002. However, nearly all of the funds have been expended, and the project remains incomplete. The subgrantee apparently did not properly budget for items necessary to complete the project, failed to obtain planned match funding, and encountered significant problems with its hired contractors. The subgrantee did not have the capacity to properly administer the project, and the facility currently sits vacant. Recently, the subgrantee failed to pay the utility bills, and the building suffered significant water damage after the fire sprinkler system pipes froze and broke (Project 6).

- One Authority subgrantee received $516,800 in NAHASDA funding to plan and develop 23 housing units. Although the portion of these NAHASDA funds allocated for the planning phase were expended, the subgrantee could not proceed with the project, and it never materialized. The subgrantee apparently did not have the capacity to administer the project and oversee its hired consultant. The subgrantee also entered into a prohibited preaward contract with its consultant (Project 7).

- One Authority subgrantee received approximately $1.5 million in NAHASDA funding for construction of a group home. The project was only partially built, and construction stopped because the subgrantee failed to properly budget construction costs and obtain its planned match funding (Project 8).

- One Authority subgrantee received approximately $232,572 in NAHASDA funding to plan the renovation of 82 housing units. The subgrantee had no prior experience in construction activities and hired a consultant without following proper procurement procedures. It allowed the consultant to take control of the project without providing proper oversight of the consultant’s activities. All of the funds were spent, yet the planning was not completed, and the renovation project was never started (Project 9).

- One Authority subgrantee received approximately $4.4 million for the planning and development of 36 housing units for staff members at a school. The subgrantee did not have experience in construction activities and did not have the capacity to properly oversee its hired contractor. Its executive director apparently did not have time to oversee both the operation of the school and the construction project. The project experienced significant delays, issues with poor construction quality, and a failure to properly budget for construction costs. The housing units should have been completed in early 2004 according to Authority staff estimates; however, the project was left incomplete, and the school for which the staff housing units were intended has since closed down. This same subgrantee was also awarded $2.1 million for planning and constructing two elderly group homes and $310,000 for planning activities associated with 30 additional housing units. However, work on this project stopped, and plans to complete the elderly homes were cancelled after the school run by the subgrantee closed (Project 10).

- One Authority subgrantee received approximately $3.3 million in NAHASDA funding for development and construction of 18 housing units for Navajo citizens who were displaced from their previous homes. The construction is nearly complete; however, the subgrantee was unable to finish the project, and it appears that a subgrantee official misappropriated approximately $170,000 of the funds. Some of the families have moved into the partially completed units and are living without power or water services. The remaining incomplete homes sit vacant (Project 11).

- One Authority subgrantee received $264,800 in NAHASDA funding to conduct planning activities for development of a group home. Nearly all of these funds were expended, yet the project never materialized. The subgrantee did not have the capacity to properly administer the project, and it appears that some of the funds were misappropriated by the subgrantee (Project 12).

- One Authority subgrantee received approximately $1 million in NAHASDA funding for the planning and development of six housing units. The subgrantee attempted to construct the homes using its own force account labor but did not have the capacity to administer the project. It also attempted to construct the units without using any formal plans and specifications, and the resulting work was substandard and not in compliance with building codes. The project ran out of construction funds before completion, and the subgrantee did not cooperate with the Authority's attempts to perform a monitoring review. In this case, subgrantee officials allegedly misappropriated a portion of the grant funds to pay for personal expenses (Project 13).

- One Authority subgrantee received approximately $1.9 million for the planning and development of single-family housing units. This subgrantee was not familiar with NAHASDA requirements, did not have an adequate plan for its force account construction activities, failed to have its construction work inspected, and did not have the capacity to oversee its own finances. The project had to be significantly scaled back after the subgrantee failed to obtain planned match funding. During a visit to one of the housing units, we found potentially significant construction quality issues that could significantly limit the useful life of the housing. Further, it appears that at least some and possibly all of the elderly individuals who were provided housing cannot afford property insurance or ongoing maintenance of the units. Neither the subgrantee nor the Authority have any plans to address this problem (Project 14).

We estimate that funds associated with the projects discussed above, which experienced significant failures associated with mismanagement or misuse of program funds as a result of inadequate subgrantee administrative capacity and/or inadequate monitoring by the Authority, exceeded $53 million. These projects and others that experienced similar problems also placed a significant and continuing burden on Authority staff, which limited their ability to provide assistance and oversight for other housing development projects. The continuing burden associated with these projects also has limited the Authority staff's ability to make needed improvements to their oversight and monitoring operations.

Subgrantee Failures Reduced Potential Housing Opportunities

The Authority's rate of housing production has decreased dramatically since the NAHASDA program was implemented and the Authority began relying on subgrantees for a portion of its housing development. Although several factors such as increasing construction costs have likely affected the Authority's rate of housing production, its reliance on subgrantees to produce much of its new housing, combined with a failure to implement adequate controls over the selection and monitoring of the subgrantees, has been a significant obstacle to achieving the programs goal of producing affordable housing opportunities.

Conclusion

The Authority's procedures for selecting and monitoring subgrantees did not ensure that NAHASDA grant funds were used in accordance with applicable federal requirements and that performance goals were achieved. As a result, many subgrantee projects were not completed in a timely manner, required additional funding or a reduction in the number of planned housing units, or were never completed. Based upon specific projects reviewed during the audit, we estimate that funds that could have been put to better use associated with subgrantee failures tied to these control weaknesses totaled approximately $53 million. The Authority acknowledged that it has had a number of problems with its subgrantees and has taken some steps to strengthen its controls; however, substantial additional improvements are needed. The Authority should 1) consider discontinuing the use of subgrantees for housing development activities and establish a new strategy for more efficient and effective housing development or 2) implement significant additional controls to ensure that funds are used in accordance with NAHASDA requirements and in a manner that will ensure performance goals are achieved in a cost-effective manner.

Recommendations

We recommend that the administrator for the Southwest Office of Native American Programs require the Authority to

1A. Consider discontinuing the use of subgrantees for construction-related projects and establish a new strategy for more efficient and effective housing development.

If the Authority continues its use of subgrantees for construction activities,

1B. Implement procedures to ensure that funds are used in accordance with NAHASDA requirements and in a manner that will ensure performance goals are achieved in a cost-effective manner.

1C. Analyze housing conditions to better target resources to geographical areas of need. The Indian housing plan should include a description of the manner in which the geographical distribution of assistance is consistent with the geographical needs and needs for various categories of housing assistance.

1D. Implement a coordinated approach to managing housing provider activities, including the development of standard operating guidelines and procedures for use by Authority staff and subgrantees.

1E. Provide precontract award oversight of subgrantee procurement procedures and consider requiring and enforcing the use of standardized fixed-price construction contracts. Require procurement be performed for construction services based upon specific plans and specifications rather than allowing consultants or general contractors to assume the entire grant amount without the controls provided by specific project requirements.

1F. Establish and implement procedures for analyzing proposed subgrantee planning and development costs to ensure that projects are not overfunded or underfunded. Before awarding subgrant funds, determine the appropriateness of subgrant amounts based upon detailed, supportable cost estimates.

1G. Require the use of certified inspectors to ensure that projects are completed in accordance with building codes and with plans and specifications.

1H. Require and enforce, through preconstruction verification, construction bonding or deposit and insurance requirements.

1I. Perform more effective reviews of subgrantee administrative capacity, including consideration of 1) subgrantee management and staff's understanding of NAHASDA requirements and the subgrantee's written policies and procedures, 2) the implementation of written policies and procedures, 3) the capacity of primary staffing involved in the administration of the construction and management of the project, 4) the subgrantee's plans for use of predetermined consultants or general contractors, 5) the verification of references for prior projects or activities, 6) the subgrantee's capacity to manage the units once completed, and 7) the subgrantee's plans for overseeing its general contractor or consultant. Provide funding only to subgrantees that have a demonstrated capacity to carry out the planned activities effectively and in accordance with NAHASDA requirements.

1J. Implement more effective controls over subgrantee payment requisitions such as requiring detailed schedules of values, independent inspection reports, and lien waivers.

1K. Implement procedures to ensure that monitoring review findings are consistently tracked and resolved within established timeframes.

1L. Implement consistent procedures to ensure that subgrantees properly account for and use program income and that this matter is fully addressed and resolved during the grant award process.

SCOPE AND METHODOLOGY

Our audit related to the Authority generally covered the period from 2003 through 2006; however, some of the activities reviewed occurred before these dates. During this period, the Authority received approximately $272 million in NAHASDA funding.

The objective of the audit was to determine whether the Authority's procedures for selecting and monitoring subgrantees were adequate to ensure compliance with NAHASDA requirements. To acomplish our objective, we

- Interviewed Authority managers and staff responsible for administering the Authority's subgrant activities.
- Performed limited reviews at three Authority subgrantees.
- Obtained and reviewed selected subgrantee payment requisitions.
- Obtained and reviewed selected subgrantee construction contracts.
- Obtained and reviewed information documenting the Authority's followup actions related to subgrantee monitoring reviews.
- Interviewed program staff from HUD's Southwest Office of Native American Programs.

We performed our fieldwork from June 2006 through January 2007. We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- The Authority's policies and procedures for selecting subgrantees.
- The Authority's controls for monitoring subgrantee construction and project management activities.

We assessed the relevant controls identified above.

Significant Weaknesses

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

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

- The Authority's controls for selecting and monitoring subgrantees were not adequate (finding 1).

APPENDIXES

Appendix A

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

Recommendation number	Funds to be put to better use
1A	$53,419,143[3]

Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. This includes costs associated with specific projects identified during the audit that experienced significant failures as a result of the finding conditions. As discussed in the finding, these projects failed to meet their planned objectives and decreased the number of potential housing opportunities created through the NAHASDA program. If our recommendations are implemented, we believe the Authority's future use of NAHASDA funds for similar projects will avoid such problems and the Authority's development activities will be more effective in meeting their planned objectives and generating housing opportunities. Funds put to better use related to finding 1 apply to all of the recommendations but, for recording purposes, we have attached all of the funds to recommendation 1A.

[3] Also see Appendix C.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

NHA Hooghan–Center of Family Growth, Strength and Beauty
NAVAJO HOUSING AUTHORITY

March 8, 2007

Joan S. Hobbs, Regional Inspector General for Audit
Region IX, 9DGA
Office of Inspector General
United States Department of Housing & Urban Development
611 West Sixth Street, Suite 1160
Los Angeles, California 90017-3101

RE: Discussion Draft Audit Report
Navajo Housing Authority

Dear Ms. Hobbs:

This letter sets forth the formal comments by the Navajo Housing Authority (NHA) to the finding and recommendations contained in the report prepared by the Office of Inspector General HUD dated February 12, 2007. On March 2, 2007 the Authority met with HUD/SWONAP and OIG officials during an exit conference where the finding and recommendations were discussed. An extension of the formal comment submission date was changed from March 1, 2007 to March 8, 2007.

Introduction

Comment 1

At the outset and as stated in the exit conference, we would appreciate the inclusion in the audit report that the audit was initially triggered at NHA's request to an OIG audit of certain housing providers given possible improprieties noted during our self-monitoring process of subgrantees. Additionally, NHA also brought to your attention the need for specific regulatory citations, if any, to support your findings. As understood, "findings" is defined as violations of applicable statutes or regulations. It is difficult to prepare any formal response to any specific allegation of non-compliance without being provided the specific citation to the applicable Federal law or regulation at question, and recognition by OIG or HUD of any remedial action taken by NHA and the subgrantee to correct any alleged non-compliance.

With respect to other areas of concern the NHA has prepared the following comments to the specific sub-findings in the order in which they are listed in the audit report:

FINDING 1: The Authority's Procedures for Selecting and Monitoring Subgrantees Were Not Adequate

SUB-FINDING: The Authority did not ensure that subgrantees had the capacity to

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P. O. Box 4980 Window Rock, Navajo Nation, Arizona 86515-4980 Phone: (928) 871-2600 effectively administer projects.

RESPONSE: On page 6, OIG makes a statement that is repeated several times throughout the report to the effect that subgrantees were not familiar with NAHASDA program requirements including those related to procurement, insurance and construction bonding, and necessary elements for soliciting and managing construction contracts. While the NHA does not object to this conclusion with respect to some subgrantees the NHA does note the contributing factor of HUD/SWONAP perhaps not providing a level of training or technical assistance at the subgrantee level to ensure that subgrantees possessed or acquired the necessary technical knowledge of NAHASDA program requirements.

Comment 2

We acknowledge and understand the position of HUD that they feel they provided sufficient training opportunities to NHA and subgrantees. Pursuant to 24 CFR Part 1000.502(b), HUD may in connection with any monitoring review of recipient activities provide technical assistance and training to obtain adequate administrative capacity. HUD monitoring review of the Navajo Nation includes not only the NHA but also its subgrantees. NHA welcomes future opportunities for HUD/SWONAP provide in a cooperative manner such additional technical assistance and training to NHA staff and any subgrantees in the event the subgrantee program continues. It is not fair to solely blame the NHA for this lack of knowledge of NAHASDA program requirements especially in light of the appropriation of funds by Congress to HUD/ONAP for technical assistance which is apparently not being provided in sufficient levels to have prevented or mitigated this sub-finding.

Within this sub-finding the report contains another assertion that the NHA did not evaluate subgrantees' plans for ensuring that completed housing units would be covered by insurance or that the intended housing management agent or residents were capable of ensuring that the units would be adequately maintained.

Comment 3

As stated earlier, neither OIG or HUD/SWONAP has provided any citation to applicable NAHASDA statutory or regulatory requirements that requires NHA or its subgrantees to provide insurance coverage or ensure maintenance responsibilities for any NAHASDA constructed units. Without a specific citation, this sub-finding poses an implication that NHA and its subgrantees must assess or charge tenants or homeowners a minimum rental or house payment rate that should correspond to the minimum rate necessary to provide insurance coverage or ensure maintenance responsibilities for said units. Applicable regulations found at 24 CFR Part 1000.124 states that "NAHASDA does not set minimum rents or homebuyer payments; however, a recipient may do so." While maintenance and insurance are eligible costs for NAHASDA assisted units we interpret NAHASDA as disfavoring any subsidy payments for such costs in light of the specific prohibition to include any new NAHASDA units in the CAS inventory and the general intent of NAHASDA to provide new and rehabilitated housing units to eligible recipients. Again, neither OIG or HUD/SWONAP was able to provide in its report or any previous communication with NHA any reference to statutory or regulatory requirements on this matter. HUD/SWONAP and OIG insistence on such requirements at this late time merely begs the question and clearly demonstrates that such supposed requirements was not provided to NHA or its subgrantees in previous IHP submittals and subsequent approvals. HUD's authority to review and approve the Navajo Nation IHP is clearly defined in NAHASDA and did not withhold approval or condition approval on compliance with any applicable law or regulation that pertains to insurance coverage or maintenance responsibilities.

It is disingenuous to now insist on such compliance requirements when no such notice had been previously provided. It is a fundamental tenet of due process and fairness to provide notice to a program participant at the outset of funding allocation and approval of IHP that such requirements exist and more importantly, may be grounds for findings in any subsequent review of program operations.

SUB-FINDING: The Authority did not properly evaluate housing needs or proposed development costs.

Comment 4

RESPONSE: The NHA does not agree with this sub-finding and assertion that it was required to conduct an evaluation of housing needs for each geographical area within its jurisdiction. While Section 102(c)(2) requires a recipient to include in its statement of need a description of the estimated housing need and the need for low-income Indians within its jurisdiction and geographic distribution it also requires a statement of the estimated need for all Indian families in the jurisdiction. The NHA believes it has complied with these requirements when it submitted its housing plan approved by the Navajo Nation to HUD. During its previous reviews and approvals of the Navajo Nation IHP, HUD/SWONAP did not provide any notice to the Navajo Nation or the NHA of the need to conduct an evaluation beyond what had been submitted since the first IHP submittal in 1998 nor did it condition its approval on submission of such an evaluation. NHA interprets said approval without any such notice or condition of approval as acceptance and approval of the statement of need for the Navajo Nation. The NHA has not interpreted NAHASDA or its implementing regulations as requiring the Navajo Nation to be divided into certain geographical areas. The evaluation of the geographical area was interpreted to mean the Navajo Nation as a whole without any subdivisions into any arbitrarily defined geographical area.

HUD/SWONAP has failed to provide any clear guidance on this matter to the NHA. For this reason the Navajo Nation IHP contains a general description of the housing need within the Navajo Nation as set forth in the 1990 and 2000 Census which happens to also be the basis for the counting of Indian populations in the NAHASDA funding allocation formula and had been approved by HUD/SWONAP with no concerns identified in the approval process. Interestingly enough the proposed 2007 IHP of the Navajo Nation has been preliminarily reviewed by HUD/SWONAP and no mention was made of the need to submit a more detailed housing need statement.

SUB-FINDING: The Authority did not conduct an evaluation of the reasonableness of subgrantees' proposed housing development costs.

Comment 5

Comment 6

RESPONSE: The NHA believed that total development costs (TDC) as established by HUD for the Southwest Region was presumed to be valid and reasonable. For that reason the NHA did not believe it was required or necessary to conduct its own survey or evaluation of the reasonableness of housing development costs for subgrantees.

With respect to submission of housing development costs by subgrantees the NHA believes that such estimates were reasonable when they were submitted and subsequent events such as sharply rising residential construction material costs, unusual soil condition problems, delays caused by NTUA for utility installations, and other governmental agencies' inaction and subgrantees' failure to obtain additional leverage funding resulted in funding shortfalls.

In addition, the NHA is seeking an adjustment in HUD's prescribed total development costs for the Navajo NM and AZ area as we believe the TDC rates are significantly lower than the actual costs to construct housing units on the Navajo Nation. What makes this relevant is that initial estimates by the NHA and subgrantees as to the reasonable housing development costs may have been much lower than the actual cost.

Conclusion

The NHA understands the challenges its faces in administering what is undisputedly the single largest Indian housing development program in the United States. The NHA also welcomes this review as a learning experience and points out that an important component of tribal self-determination and self-governance is the right to make mistakes and to learn from them.

The NHA acknowledges that it may not have implemented its housing program in the most efficient and effective manner and that it may not have implemented adequate controls over its subgrantees during the first seven years of the NAHASDA authorization. However, it should be noted that the NHA developed and implemented the NAHASDA Indian Housing Block Grant Management System in FY 2006 by which stringent controls were installed to select subgrantees which demonstrated the administrative capacity to manage NAHASDA grants and to strengthen the NHA's monitoring reviews of subgrantees. The focus of this OIG audit was for the most part on subgrantees which were awarded grants prior to FY 2005. It should be noted that the NHA did cooperate fully with the OIG audit as we initially requested OIG involvement, that it provided boxes of documents in its possession and directed its employees to fully comply with all requests for documents and interviews. The NHA did inform OIG of specific instances of non-compliance by subgrantees of NAHASDA program requirements and did vigorously implement corrective actions plans requested by HUD/SWONAP as a result of the many monitoring review audits.

We appreciate OIG Audit's assistance in conducting this review and we will take all actions necessary to ensure tightening of our internal control mechanisms and utilize HUD/SWONAP technical assistance and training for the benefit of the NHA and its subgrantees in the event we continue the subrecipient program currently under serious re-evalution by the NHA management.

Sincerely,

Aneva J. Yazzie
Chief Executive Officer

cc: Leonard Teller, Chair BOC
Martin Avery, General Counsel
Subject/Chrono/Central

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OIG Evaluation of Auditee Comments

Comment 1 The Authority felt that OIG did not provide specific statute or regulatory citings to support our findings of noncompliance set out in the report. However, the finding does set out the applicable statutory and regulatory requirements that form the very basic management prerequisites of not only NAHASDA, but also most other federal grant programs. That is, 24 CFR 1000.6 of the NAHASDA regulations requires that recipients "must have the administrative capacity to undertake the affordable housing activities proposed, including the systems of internal control necessary to administer these activities effectively without fraud, waste, or mismanagement." Further, Office of Management and Budget Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments (adherence with which is required by 24 CFR 1000.26), Attachment A, paragraph A.2.a. states that application of cost principles is based on the fundamental premises that, "(1) Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices." Essentially, the report states that the Authority did not have policies and procedures in place to assure that these very basic management requirements were met, especially as it related to controls over subgrantee activities.

Comment 2 The Authority's response did not object to the finding conclusion, yet states that the cause of this problem may have been partially attributable to a purported failure by HUD's Southwest Office of Native American Programs to provide adequate training or technical assistance to the Authority's subgrantees.

The audit report findings involve control weaknesses that exist within the Authority's own housing development program operations. The Authority should request assistance from HUD as needed, however, the Authority, as the tribally designated housing entity, is ultimately responsible for administering its housing program and ensuring its activities comply with NAHASDA program requirements.

Comment 3 The Authority's response questions the audit report conclusion that the Authority should review subgrantees plans for ensuring that completed units will be properly maintained and that required insurance is obtained.

In regard to ensuring subgrantees have plans or capacity to ensure units will be properly maintained, the Authority's housing development program should focus on activities that provide lasting solutions to address the severe housing shortage on the Navajo reservation and should direct program resources to programs and processes that have basic controls to protect the limited resources available to the program. Accordingly, it is only reasonable that consideration be given to the subgrantees' plans for ensuring that appropriate means are in place to ensure the assisted units are maintained. The audit report does not suggest that the Authority or its subgrantees should subsidize the maintenance activities on all units assisted, but rather that the Authority should ensure the subgrantees have adequate plans or capacity to provide for property management on rental units or plans to consider the ability of proposed home occupants to maintain the homes using their own resources. For example, subgrantees should not construct a three bedroom home for an elderly, disabled person that lives alone, without consideration given to the homeowner's plans or ability to provide for maintenance of the home. Likewise, the Authority should not fund a multi-million dollar rental housing project without adequate consideration given to the plans and capacity of the subgrantee to properly manage and maintain the project. It is not prudent to invest the Navajo's limited NAHASDA grant resources in projects without taking such appropriate steps to ensure adequate planning has been performed to ensure the housing will remain safe and sanitary and provide a long term solution for the involved Navajo citizens. In this regard, Section 202 (e) of the NAHASDA statute states "Each recipient shall develop policies governing the management and maintenance of housing assisted with grant amounts under this Act".

In regard to NAHASDA insurance requirements, please note, Section 202 (c) of the NAHASDA statute states "Each recipient shall maintain adequate insurance coverage for housing units that are owned or operated or assisted with grant amounts provided under this Act". Also, for developments under construction, the implementing regulations for NAHASDA at 24 CFR 1000.136 (c) require that that NAHASDA recipients "shall require contractors and subcontractors to either provide insurance covering their activities or negotiate adequate indemnification coverage to be provided by the recipient in the contract".

In accordance with 24 CFR 1000.136 (b), insurance is not required on units assisted by grants to families for privately owned housing if there is no risk of loss or exposure to the recipient or if the amount of assistance is less than $5,000 and repayment of all or part of the assistance is not a part of the assistance agreement. However, NAHASDA does recognize the risk that can result from a lack of insurance and accordingly 24 CFR 1000.140 of the NAHASDA regulations allows for recipients to "purchase insurance for privately owned housing to protect NAHASDA grant amounts spent on that housing."

Comment 4 The Authority's response claims it is not required to conduct an evaluation of housing needs for each geographical area within its jurisdiction. We disagree with the Authority's comment since this is a very specific requirement of the NAHASDA program. Section 102(c)(2) of the NAHASDA statute requires that the following two distinct items be submitted to HUD as part of the one-year housing plan:

> (A) "a description of the estimated housing needs and the need for assistance for the low income Indian families in the jurisdiction, including a description of the manner in which the geographical distribution of assistance is consistent with the geographical needs and needs for various

> categories of housing assistance; and (B) a description of the estimated housing needs for all Indian families in the jurisdiction."

It should also be noted that at the March 2, 2007 exit conference, officials of HUD's Southwest Office of Native American Programs confirmed that, although the Authority may not have provided an evaluation of housing needs by geographic area in the past, such an evaluation is required by the NAHASDA regulations and should be developed and submitted to HUD as part of its annual housing plan.

Comment 5 The Authority's response states that it believes subgrantees' cost estimates were reasonable when they were submitted and that no consideration beyond HUD's established total development costs is necessary. Further, the Authority felt that funding shortfalls were caused by rising costs, not the failure to determine accurate cost estimates at the time of project funding, and that because of these rising costs they have requested adjustments to HUD's prescribed total development costs for its jurisdiction.

This comment demonstrates the precise problem with the Authority's methodology for determining grant amounts for proposed subgrantee construction projects. It indicates that the Authority was willing to fund subgrantees for the maximum amount permissible under the NAHASDA program, regardless of the projects' design or actual budget requirements which could vary significantly from project to project. This methodology assumes that all proposed projects (by type) are identical in their design and potential cost requirements, yet this is not true. As noted in the report, Authority staff indicated that in some cases subgrantees did not have any idea what their actual costs would be until three to four years after they received funding from the Authority and, in some cases, subgrantees failed to properly budget for construction costs and were forced to halt construction and/or seek additional funding from the Authority. Without consideration given to actual cost requirements based upon supportable project cost estimates and design requirements, the potential for overfunding or funding shortages will be increased, particularly since many of the Authority's subgrantees lacked construction industry knowledge and experience. Accordingly, although the subgrantees may have faced increased costs during their drawn out development periods, these increased costs simply exacerbated the already serious problem of unsupported and in reality completely unreliable cost estimates used to determine initial project funding.

Furthermore, as noted in the report, providing fixed (and potentially excessive) amounts to subgrantees without regard to specific project requirements, increases the potential for abuse by contractors or consultants who may seek to inappropriately exploit the existence of available funding surpluses or to reduce the scope or quality of the projects to maximize their own potential for profit. By allowing subgrantees to assume the maximum allowable grant amounts without regard to design requirements and supportable cost estimates, the Authority's subgrantee program lacks essential controls to ensure project costs are reasonable and that allocated funding amounts are appropriate. An increase in the prescribed total development costs as requested by the Authority, without detailed project designs and accurate budget cost estimates, would only make this problem worse.

Comment 6 The Authority acknowledged it may not have implemented its housing program in the most efficient and effective manner and that it may not have implemented adequate controls over its subgrantees, yet states that stringent controls were implemented in 2006. The Authority stated they are willing to take steps to further strengthen controls and will seriously reevaluate continuation of its subgrantee program. The response also noted the Authority cooperated fully with HUD OIG's audit.

Although the Authority indicated it has considered implementing some of the controls recommended in the audit report, none of the recommendations cited in the report have yet been implemented as part of the Authority's operations. Without implementation of the additional controls recommended in this report, the controls that the Authority has implemented will not be effective.

We appreciate the Authority management and staff's full cooperation, and the assistance they provided to our staff during the audit.

Appendix C

SCHEDULE OF FUNDING PROVIDED TO FAILED PROJECTS CITED IN THE AUDIT REPORT

Project Reference Number	Funding Amount
1	$ 12,050,000
2	$ 14,523,809
3	$ 1,941,644
4	$ 3,000,036
5	$ 3,375,000
6	$ 2,893,815
7	$ 516,800
8	$ 1,453,000
9	$ 232,572
10	$ 6,832,509
11	$ 3,303,272
12	$ 264,800
13	$ 1,064,535
14	$ 1,967,351
Total	$ 53,419,143