Integrity Bulletin
U.S. Department of Housing and Urban Development
Office of Inspector General

"In government contracting, we can't afford the luxury of mistakes. You must be aware of what is going on and what you can do to protect both the government and yourself."
– Federal Acquisition Institute

Procurement & Contracting: Five Ground Rules for Grantees and Subrecipients

Purpose

Goods and services must be procured in an effective manner and in compliance with Federal, State, and local laws. These laws exist to ensure that funds are awarded through fair and open competition and are spent on eligible and reasonably priced goods and services. Although the majority of grantees and subrecipients comply with these rules and regulations, we are issuing this bulletin to assist you in identifying potential weaknesses in procurement and contracting procedures. Weak or nonexistent procurement policies and management oversight can entice some employees to manipulate contracts to their personal benefit and can result in costly, wasteful, or unenforceable contracts. However, the very act of monitoring procurements and contracts has a deterrent effect on fraud and poor management and thereby enhances the integrity of the program.

While the information contained in this bulletin does not supersede previously issued guidance currently in effect, it should serve as a useful tool in highlighting important requirements and establishing self-assessments of your procurement and contracting activities.

Background

Federal grants are covered either by a new common rule at 2 CFR (Code of Federal Regulations) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, or the previous version at 24 CFR Parts 84 and 85 (for grants made before December 14, 2014). Grantees are also required to follow applicable State or local laws on procurement, depending on their location. If there are inconsistencies among Federal, State, or local laws, the strictest of the requirements applies.

Although the administrative procedures concerning procurement may vary, there are several major requirements that should be met consistently. While reviewers must concentrate on administrative compliance, they also should be alert to indications of fraud and abuse. When indications of irregularity are uncovered, additional assessment of the situation may be needed. It is prudent for elected officials and executives to be alert to any controversies or complaints regarding these activities and the staff responsible for them.

Ensure That Five Ground Rules Are in Place

A primary duty of elected officials and executives in regard to procurement and contracts is to ensure that policies and procedures are in place and comply with all Federal, State, and local requirements. Ask any business leader what is the greatest challenge in these times, and the most likely answer will be "to manage costs." Procurement and contracting are key areas in which grantees can control costs. Generally, elected officials approve the procurement policy, and executives are responsible for executing the policy and ensuring that it is followed. Regardless of whether the executive administers procurement directly, delegates it to other officials or subrecipients, or contracts out the procurement process, the grantee is ultimately responsible. You should ensure that checks and balances are in place to detect and prevent violations of procurement rules and procedures. In other words, internal controls and a quality control system should be in place so you can have assurances that rules are followed. While you must follow all requirements, you will position yourself well for meeting other rules by ensuring that five basics are in place.

1. Maintain Separation of Duties

> The most direct way to prevent fraud is to eliminate the opportunity.

The person(s) delegated to do the ordering should be different from the person(s) receiving and accepting the goods and the person(s) paying for the order. When this is not possible due to the limited size of staff or when the process is decentralized, as in the case of an outstationed project manager, additional rules should be used, such as limiting dollar authorizations and periodic reviews by an independent individual. The grantee should ensure that only designated individuals have the authority to make binding contracts. If you have a small staff, you must devise a method for independent oversight. The rule of thumb should be that if an employee touches the money, mail, or goods purchased, he or she should not touch the books.

Example of Inadequate Separation of Duties

- An audit found that all Community Development Block Grant (CDBG)-related mail, including vendor invoices, was opened by a finance director. The director also was responsible for cash receipts and reconciling bank statements. Because this violated the separation of duties principle, the director should have had someone else who didn't have access to the financial records, be responsible for opening and logging in the mail. In addition, bank reconciliations should be done by an employee who is not responsible for cash receipts.

2. Provide Competencies and Training

A best practice for grantees is to have a knowledgeable entity review their procurement policies and procedures to ensure that they meet HUD and Office of Management and Budget requirements. In addition, contracting staff should be sufficiently trained to perform its duties and meet its responsibilities.

Many Federal and State contracting officers have strict training requirements, but these requirements may not always flow down to the local grantee or subrecipient level. Many of the grantee's expenditures go through this process, making it a high-risk area requiring competent and ethical staff that performs at a high level.

For this reason, it is up to the grantee to ensure that a standard is in place and that anyone hired to conduct

procurement activities has appropriate training and experience. The grantee should also provide continuing training in procurement and contracting to ensure that its staff keeps up to date on procurement requirements, such as the new 2 CFR Part 200. Training is available from many State agencies, the National Procurement Institute, the Public Contract Institute, or private firms, but it must be tailored to Federal grant requirements.

Example of Poor Policies or Training.

- City councilmembers approved a construction contract for $782,215 for the rehabilitation of 28 residential streets. A month later, the councilmembers approved a change order that increased the contract from $782,215 to more than $2.1 million, which allowed the contractor to perform additional construction work on 16 more residential streets. Regulations required that the city make available preaward review procurement documents, such as proposals or invitations for bids, independent cost estimates, etc., when a proposed contract modification changed the scope of a contract or increased the contract amount by more than $100,000. Although the city obtained approval from councilmembers for the material change order, there was no documentation to show that it performed a cost or price analysis as required by 24 CFR 85.36(f)(1). This condition occurred because the city had policies and procedures that were separate from its implemented program procedures, which did not consider applicable HUD rules and regulations to ensure proper documentation of its program-funded procurement actions. The grantee should have used the HUD-required procurement rules.

3. Insist on Good Record Keeping

Grantees should ensure that policies and procedures are comprehensive regarding the level of documentation to be maintained on procurements and contracts. While outside parties or subrecipients may conduct the procurements, the grantee is responsible for ensuring that all original records are available and readily accessible for audit or other reviews.

While it is not required, you may want to consider requiring that periodic reports on procurement activities be reviewed by management to ensure transparency and integrity in the process. Reviewing these reports may disclose conflicts of interest or other abuses. Reports to consider obtaining are

- **A spend map**, a periodic plan for what is to be bought. Understand what (and how) you and your subrecipient spend.
- **A contracts register** of vendors, contractors, and subcontractors by date and type of procurement (micropurchases, small purchases, requests for proposals, and sole-source and competitive bids), funding source, and amount of the contract, along with a brief description.
- **A Summary of change orders** by contract.
- A report that **cross-checks** vendor addresses and phone numbers with those of employees.
- A report of any **purchases lacking invoices**.

Examples of Poor Record Keeping

- During an audit, a city did not provide complete file documentation for its procurement and expenditure transactions, resulting in many requests for missing documents. After the audit fieldwork ended, the city provided more than 18,000 pages of documentation to support its procurements and expenditures. A review comparing the work activity logs, provided as support for payments for a drainage cleaning

contractor, to the contractor's invoices found that the work activity logs were not complete. The city will need to work with HUD to review the records and determine whether they support the procurements and costs claimed. The grantee should have ensured that it received and maintained all necessary support. In labor hour contracts, the city needed to ensure that it received signed time and attendance reports and that those reports indicated which hours were for which approved activities.

- An audit of a State found that it did not require its contractor to bill by the detailed tasks listed in its $144 million CDBG Disaster Recovery-funded contract. Since the State allowed the contractor to bill by position and total hours worked, it could not determine what tasks the contractor had completed or whether it had overpaid the contractor for any task. The State should have required the contractor to bill by task.

4. Maximize Competition

Ensuring that procurements are conducted and contracts are awarded in a way that obtains the most competition will serve the agency well. If you encounter any of the issues listed below, you should dig deeper to ensure that procurements are being made properly:

- Use of sole-source contracts,
- Insufficient price or rate quotes from qualified sources,
- Lack of independent cost estimates or cost analyses,
- A failure to rotate vendors on lower priced purchases,
- The use of unreasonably narrow or specific qualification criteria or bid specifications,
- Short timeframes for responding to offers,
- An insufficient number of responsive bidders,
- Overuse of change orders,
- Failure to check government debarment lists,
- Overuse of small purchase contracts,
- Lack of outreach to women and minority business enterprises, and
- An excessive number of small purchase contracts close to the small purchase dollar limit.

Example of Poor Procurement Practices

- An Authority's procurement process for its HOME Investment Partnerships Program had significant problems. The Authority awarded 27 contracts valued at $1.8 million to 10 contractors during the audit period. The Authority:

  - Accepted faxed bids in the procurement process for four clients. There were two contracts awarded based on a faxed bid. The related payments totaling $114,014 were unsupported. Regulations at 24 CFR 85.36(d)(2)(ii)(C) state that if sealed bids are used, all bids will be publicly opened at the time and place prescribed in the invitation for bids. The grantee's program manual required sealed bids.

- Executed a contract for services when different sealed bids were submitted on the same day from the same contractor for the same project, which resulted in an unsupported payment of $8,000. There was no documentation explaining why the bid awarded was greater than the lowest bid submitted. Regulations at 24 CFR 85.36(d)(2)(ii)(D) state that a contract will be awarded to the lowest responsive and responsible bidder.

- Paid contractors before inspection and project completion contrary to the Authority's management plan requirements. The Authority's management plan states that the Authority must ensure that work is inspected before making payment to contractors.

- Did not ensure that the amount of the bid submitted by the contractor equaled the accepted bid amount on the bid summary. The bid form submitted by the contractor listed a bid in both numerical and written form, and the Authority accepted the numerical bid amount. The Authority's bid form states that bid amounts must be stated in both words and figures and that in case of a discrepancy, words will govern.

- Accepted bids for demolition services when the demolition method was not known at the time the bids were received. Since the demolition method was not known, the Authority could not have determined an accurate cost estimate. Regulations at 24 CFR 85.36(f) state that subgrantees must perform a cost or price analysis in connection with every procurement action. Grantees must make independent estimates before receiving bids or proposals. It was determined later that the demolition work was not done on several units, although the grantee paid for the work.

5. Uphold Ethics and Bar Conflicts of Interest

HUD requires that a written code of standards be included in the procurement policy, and many State and local conflict-of-interest laws also have requirements. Ensure that your guiding principles bar those in positions of trust from personally gaining from transactions and that the process is fair to all seeking to do business with the grantee or subrecipients.

A common problem is the lack of understanding of what "appearances of conflicts" entails. Too often, managers believe that indirect or noncash gifts are not considered a conflict of interest. Examples are vendor or contractor donations to employee fund-raising drives, event tickets, meals, or giveaway gifts like a Thanksgiving turkey or iPad drawing given to an employee-affiliated organization. These gifts could be considered potential conflicts of interest so it's best to be wary of accepting anything of value from a contractor. If you are unsure whether it is legal or creates an appearance of a conflict, seek expert advice.

As a grantee, you have an obligation to not only avoid conflicts of interest yourself, but also to be alert and question real or apparent conflicts by any others, including subrecipients. Conflict-of-interest restrictions also extend to immediate family members, business partners, or organizations where they may be employed or seeking employment.

Ethics also entails maintaining integrity through strong financial controls to avoid embezzlement and theft of assets. During fiscal years 2011 to 2015, the Office of Inspector General (OIG) investigated and obtained 239 convictions of grantee staff members or contractors.

Examples of Ethical Violations

- A grantee, through its subrecipient, administered its CDBG revolving Economic Development Loan programs, including a commercial loan program. A commercial loan of $200,000 was made at a 2 percent interest rate to relocate several manufacturing businesses into one central location. There was a potential conflict of interest as the loan was made to a local for-profit corporation, the president of which was also on the board of directors of the subrecipient that made and administered the loan on behalf of the city. HUD regulations prohibit participation in the administration of a contract if there is a real or apparent conflict of interest. The grantee should have been aware of and monitor for conflicts of interest between a subrecipient and entities that it supported with grant funds.

- Following an OIG investigation, a former CDBG grant administrator was sentenced to 36 months probation and ordered to pay restitution to HUD in the amount of $116,064. Over a 4-year period, the defendant received a salary from a city department as the grant administrator and also formed a company and was its executive director. The defendant awarded several CDBG contracts to this company. He collected a salary from the city as a grant administrator and also collected a salary as the executive director of his company, which was paid using CDBG funds.

In Summary – Stay Alert

Most procurement and contracting problems come to light through complaints, protests, and alertness to unusual circumstances. Be sensitive to any findings on the procurement process by your independent public auditor. Also, be vigilant for any controversies or complaints regarding these activities and the staff members responsible for them. You should understand the types of purchases that are not allowed or exceed needs. Remember, even allowable costs can be disallowed if they are unreasonable or not for an eligible or allowed purpose. While there are many schemes and poor practices in the procurement and contracting areas, following the above basics will give you and your agency a advantage in preventing and detecting fraud and avoiding repayment of funds. If you are in doubt about a situation, don't ignore it. Get advice from your counsel, HUD office, or other experts.

Serious allegations of fraud should be reported to your local HUD Office of Inspector General or to the HUD OIG hotline at http://www.hudoig.gov/report-fraud.