Integrity Bulletin
U.S. Department of Housing and Urban Development
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Implementing the Five Key Internal Controls

Purpose

Internal controls are processes put into place by management to help an organization operate efficiently and effectively to achieve its objectives. Managers often think of internal controls as the purview and responsibility of accountants and auditors. The fact is that management at all levels of an organization is responsible for ensuring that internal controls are set up, followed, and reviewed regularly. The purposes of internal controls are to:

- Protect assets;
- Ensure that records are accurate;
- Promote operational efficiency;
- Achieve organizational mission and goals; and
- Ensure compliance with policies, rules, regulations, and laws.

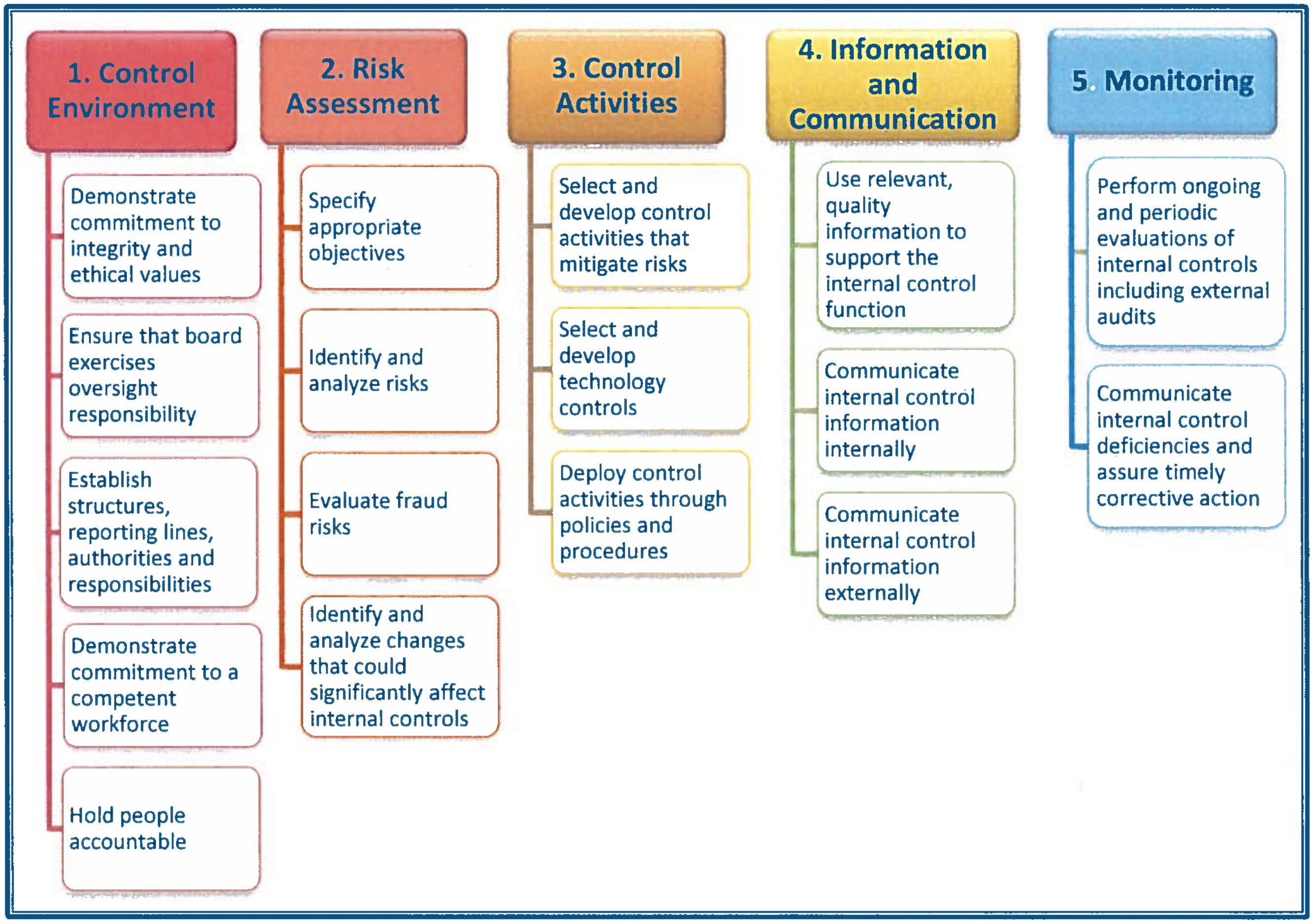
In administering various U.S. Department of Housing and Urban Development (HUD), Office of Community Planning and Development (CPD) programs, all grantee and subrecipient organizations deal with risks to achieving their organizational and programmatic goals. No rules, bad rules, or failure to follow rules disrupt the effectiveness of the internal controls and, ultimately, mission delivery. This bulletin explains the five internal control standards and ways to implement them effectively. It also provides case examples of deficiencies in internal controls and how those issues could have been avoided through use of internal controls.

Background

If your grant or subgrant is subject to the uniform administrative requirements of 2 Code of Federal Regulations (CFR) Part 200, then 2 CFR 200.303 requires that your organization follow one of the two approved internal control frameworks. The Government Accountability Office (GAO) Standards for Internal Control in the Federal Government (commonly called "the Green Book") is one of the frameworks, and the Committee of Sponsoring Organizations (COSO) has issued the other. The former is used by the federal government, while publicly held companies use the latter.

Both GAO and COSO provide a framework for designing, implementing, and operating an effective internal control system. Using either will help achieve your objectives related to operations, reporting, and compliance. The frameworks have 5 components of internal control and 17 sub-principles.

Summary of Internal Control Standards



These standards are the foundation of good management and are described in more detail below.

Key 1. Establish a Control Environment

The control environment is the culture, values, and expectations that organizations put into place. Ways to establish and nourish the environment are:

- Set "tone at the top" by implementing and promoting ethical standards, integrity, and accountability policies;
- Set mission, goals and objectives (strategic planning) so the organization knows what it is to accomplish;
- Establish structure, organizational responsibilities, and reporting chains;
- Hire competent and trustworthy staff members and provide necessary training for them;
- Provide leadership and good governance by staying on top of operations and performance, and correcting problems when identified;
- Emphasize that compliance with laws and regulations is the expectation for the organization;
- Assure that goals and objectives are clear (especially when there are multiple grant awards) and not in competition with each other or compliance requirements; and
- Hold people accountable for their responsibilities.

<u>Example of weak control environment</u>
An audit of a grantee found deficiencies in six of seven contracts reviewed.
Problems included insufficient evidence that contracts were adequately competed, missing

contract forms and provisions, lack of justification supporting sole-source contracts, and board of commissioners' approvals signed after contract execution or missing. Further, auditors discovered that forms were added to the contract files after the request to review them and evidenced the use of correction fluid to conceal the date printed. The executive director acknowledged that the former purchasing director removed files from the organization. The executive director decided to create or reproduce the documentation before giving the files to the auditor. The audit recommended referral of the executive director to HUD's Departmental Enforcement Center for appropriate action regarding the questionable ethical conduct. The agency should have had policies concerning documentation, record archival, and removal of official records from the office.

Key 2. Conduct Risk Assessments

In the past, risk management focused exclusively on financial dangers. Enterprise Risk Management (ERM) looks at the entirety of an organization and everything that could affect it. Leadership should oversee a risk management process and ways to accomplish this are:

- Have each function identify the risks to operations and performance;
- Brainstorm with staff to determine possible external risks (See the appendix at the end of the bulletin that shows examples of types of risks);
- Learn about emerging risks through employee and customer surveys, etc.;
- Consider the potential for fraud when identifying, analyzing and responding to risks;
- Rate and rank the risks, and discuss controls or other actions needed to eliminate or reduce the risk;
- Develop corrective actions and assign someone to be in charge of implementing each.

Key 3. Implement Control Activities

Control activities are the policies and procedures put into place to run operations, accomplish goals, and prevent fraud. Basic internal control methods are:

- Establish responsibility;
  - Assign each task to only one person.
  - Establish organizational structure.
- Implement separation of duties;
  - Don't make one employee responsible for all parts of a process.
  - Use compensating controls, such as additional monitoring or secondary sign-offs, when separation is not possible.
- Restrict Access;
  - Don't provide access to systems, information, assets, etc. unless needed.
- Create policies and procedures;
  - Implement written instructions with directives to follow them.
  - Assure controls cover all areas of compliance.
  - Assure controls cover security of assets and technology.
- Establish record keeping;
  - Document all expenditures and the justifications for them.

<u>Example of lack of control activities</u>

A grantee city spent $284,649 in program funds on projects that did not have required executed written agreements with its internal departments and subrecipients. Agreements or memorandums of understanding for these projects should have included the purpose statements and the national objectives they would meet. This condition occurred because the city did not have internal controls to ensure that internal departments and subrecipients signed agreements before spending program funds. The lack of agreements kept the city from having the authority to monitor the work. The city should have had written policies and checklists to ensure that it had agreements or memorandums of understanding for these projects in place, and should have included the purpose statements and the national objectives the projects would meet. It also should have had controls over spending to ensure that program staff could not spend funds before signed agreements were properly in place.

Key 4. Implement Information and Communication Systems

Communications are essential for every organization. They rely on quality of information and effectiveness of dissemination. Use the following suggestions to guide your information and communication protocols:

- Establish relevant and reliable information systems to track operations, goal progress, and compliance;
- Broadly distribute information throughout the organization to ensure that critical information is delivered to the right staff in a timely way. Ask staff members what information they need but are not getting;
- Establish separate lines of communication, such as fraud and ethics hotlines, for confidential information. Inform employees of these separate reporting lines, how they operate, and how reports are handled;
- Establish both outgoing and incoming lines of communication with external entities. Stay aware of external events that could pose a risk.

Example of problematic information and communications
Seven years after a local government grantee got $10 million in Federal money to build a cemetery and bus station, neither had been completed. Local authorities claimed they had no documentation about the projects, such as approved work drawings and as-built plans. The local government said it had no information about its own decisions because contractors had the only copies of the paperwork and were holding them for "ransom." The contractors said they did not cooperate because the local government had not paid them for completed work. The local government should have had a system for capturing information regarding the status of projects, maintained reports available, and provided them to decision-makers, as needed. The local government grantee should have maintained all original records.

Key 5. Monitor Internal Controls

Establishing controls is not enough. Once they are in place, managers need to verify the effectiveness of the controls. Ways to accomplish this include:

- Establish a system of quality control over all processes such as supervisory reviews, approvals, and automated exception checks;
- Conduct routine reviews of actual performance compared to goals and budgets;
- Conduct separate management reviews of a function to determine whether it is working as intended, or controls need to be redesigned. Use the GAO Internal Control Management and Evaluation Tool to evaluate your internal controls;
- Arrange for external audits and be responsive to findings;
- Track all corrective actions, and ensure that they are implemented and working as intended;
- Use monitoring to tie corrective actions back to improvements in Control

Environment and Control Activity standards;
- Watch for signs of control problems.

Even strong controls do not always work. As you implement controls be mindful that all of the controls systems are dependent upon people. The effectiveness of internal controls is directly proportional to staffs' willingness to adhere to them.

Example of inadequate monitoring of internal controls
An audit noted that a grantee had inadequate management oversight of its property and financial records. In addition, the grantee lacked adequate policies, procedures, and internal controls governing the use of vehicles, cellular phones, and credit cards. Staff regularly used these assets for personal activities. Paperwork was incomplete and supervisory review was nonexistent. Factors contributing to this noncompliance were the board of commissioners' failure to exercise its leadership and monitoring function. The board or other leadership should have had policies and procedures for the review and approval of expenses and use of assets. They should also have had a means to check that these controls were working through spot checks or other independent means such as audits. If management had monitored expenditure reports, it would have been alerted to the unauthorized spending.

Getting Help

Senior managers are responsible for internal controls, which are key to an organization's ability to achieve its goals. There are five basic standards that managers of CPD grantee organizations should use to ensure effective and efficient operations. Management's use and enforcement of the above methods is a major indicator of an organization's commitment to successful governance.

There are many internal control training and ERM programs available on-line. Many States also offer training or certification programs, as do many associations, including the Institute of Internal Auditors, the American Institute of Certified Public Accountants, the Association of Government Accountants, and the Committee of Sponsoring Organizations. There are also many private training companies that offer generic management and internal control training. You can also consult your local HUD office or independent auditor for ways to improve specific issues you may have with internal control issues.

If you have knowledge of possible fraud, you must promptly report it to your local HUD Office of Inspector General or online at HUD's hotline: https://www.hudoig.gov/report-fraud%20.

Appendix

Examples of Risk Types and Risks

Governance	Financial	Business operations	Compliance and legal	Stakeholders	Physical environment
Weak leadership (ignoring management problems)	Poor budget controls or poor accounting systems	Human capital problems (hiring, performance, training, diversity issues etc.)	Ignoring audit or monitoring findings	Congress funding and passing new laws	Poor safeguarding of physical assets (buildings, equipment, etc.) from loss, damage, and theft
Lack of risk Identification			Not knowing rules	New State and local laws	
Missed or unclear project goals	Unsupported payments	Information technology issues (Equipment, systems, programs, etc.)	Lawsuits, health and Safety issues	New Federal regulations	Physical location risks: Natural Disasters, Super fund site, Flood prone site, etc. Economically depressed site
Pressure on staff that undercuts integrity	Access to cash and accounting records		Allowing discriminatory practices		
Ineligible project activities	Purchase or travel card abuse	Poor recordkeeping	Faulty procurement processes	Political pressures	
Hiring for positions of trust without proper vetting.	Contractor billing Issues	Untimely or Inaccurate reports and communications	Federal law violations	Citizen complaints	Distances to Sites
		No quality control processes	Conflicts of interest		Difficulties Getting to sites
Weak organizational structure	Allowing conditions for embezzlement and other financial fraud	Contractor performance issues	Data security and privacy issues	Bad publicity posing reputational risks	Deteriorating or aging assets (buildings , equipment, and infrastructure)
Failure to monitor goals and finances		Lack of or outdated policies and procedures	Inadequate monitoring of sub-awardees		

While these categories and examples are not all inclusive, they show the breadth of areas senior leadership must consider and manage, to the extent possible.

OFFICE of INSPECTOR GENERAL
UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

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7 Keys to Handling Conflicts of Interest

Conflicts of interest arise when officials or staff stand to benefit--either directly themselves or indirectly through business partners or relatives--from the awarding or contracting of grant funds. Grantees are encouraged to avoid conflicts of interest to the extent possible. When conflicts of interest arise, grantees must identify, disclose, and manage them in compliance with applicable rules and regulations. When conflict-of-interest issues are overlooked or hidden, this creates problems for the individuals involved, as well as grantees, subrecipients, or contractors. This bulletin discusses common types of conflicts of interest, offers best practices for avoiding and managing them, and the potential consequences of not handling them appropriately.

Identify, disclose, and manage all real and apparent conflicts of interest through elimination, mitigation, or waivers.

1. Know the Requirements.

In general, conflicts of interest occur when one's private interest and public duties overlap, resulting in a real or perceived lack of independence or impartiality. Common situations include:

- Elected officials voting on awarding of funds to organizations where a family member is on the staff or where the elected official is on the subrecipient's board;
- Executive directors of subrecipients entering into contracts with companies they are affiliated through employment of, or ownership by, themselves or their relatives;
- Grantee officials or staff who have relatives who may benefit from a subrecipient's programmatic activities; and
- Failure to notify the U.S. Department of Housing and Urban Development (HUD) about conflicts of interest, or late and or incomplete requests for exceptions.

The existence of a conflict of interest does not necessarily mean that any individual acted improperly or illegally, but it does mean that, unless properly handled and addressed, he or she could end up being in violation of Federal rules. Therefore, all such cases must be identified and resolved by eliminating the conflict or obtaining a written exception.

Two sets of conflict-of-interest rules exist – one for procurement activities and others for non-procurement, sub-granting/program delivery activities.

A. **<u>Procurement Standards</u>**: Regulations at 2 CFR (Code of Federal Regulations) 200.318(c) require non-Federal entities to maintain written standards of conduct

B. covering conflicts of interest, including organizational conflicts of interest. Organizational conflicts of interest occur when, because of relationships with a parent company, affiliate, or subsidiary organization, the non-Federal entity is unable or appears to be unable to be impartial in conducting a procurement action involving a related organization.

Regulations are in transition between grants issued before December 26, 2014 (when 2 CFR Part 200 went into effect), and those issued later. See the footnote below for more detail.[1]

Example of a Procurement Conflict of Interest

- A Neighborhood Stabilization Program (NSP) grantee funded a subrecipient to rehabilitate 28 homes. The subrecipient failed to report a conflict-of-interest situation when it entered into two contracts with a construction company that was 50 percent owned by the NSP subrecipient's executive director. Although the subrecipient stated that it had disclosed all relationships to the grantee in the proposal process, the grantee overlooked HUD's conflict-of-interest requirements and the requirements found in the agreement. Because the grantee approved the proposal and awarded the agreement, the subrecipient believed that there were no conflict-of-interest issues. The grantee should have flagged the conflict of interest situation during its risk assessment of the subrecipient and prohibited the use of the executive director's construction firm.

B. **Non-procurement Standards**: Regulations at 2 CFR 200.112 require HUD to establish conflict of interest policies for Federal awards and require non-Federal entities to disclose in writing any potential conflict of interest to HUD or a pass-through entity in accordance with HUD's policy. HUD is finalizing its conflict-of-interest policy, but entities are still expected to use the policies developed under the various Community Planning and Development (CPD) program-specific regulations. In general, all CPD program regulations prohibit grant-assisted activity benefitting relatives of people who work for the grantee or the pass-through entity.

Example of Non-Procurement Conflict of Interest

- A city awarded a Community Housing Development Organization (CHDO) $215,975 in HOME funds to sell and construct one single-family home. At the time of the award, a city official's daughter was the president of the CHDO. The city official abstained from voting on the basis that there was a relationship with the executive director. However, the city was required to disclose these relationships to HUD and had not done so. The city should have developed and implemented written procedures to ensure compliance with HUD's conflict-of-interest regulations, including disclosure of potential conflict-of-interest situations.

[1] For more detail see Special Directive SD-2015-01, dated February 26, 2015 "Transition to 2 CFR Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Final Guidance. (http://portal.hud.gov/hudportal/documents/huddoc?id=15-01sdn.pdf)

2. Train Employees

Grantees and subrecipients ought to build an organizational culture that is conscious of potential conflicts of interest so that action can be taken to avoid or mitigate conflicts as they arise. Provide conflict-of-interest training for all employees, including those of the organization and the governing authority, the organization's leadership and, as appropriate, the organization's agents. To have the most impact, the organization should have a written policy requiring annual conflict-of-interest training, and legal counsel or other qualified individuals should review the policy with employees (and board members), subrecipient officers, and pass-through entity staff at least annually. Documenting training is a best practice. The organization should:

- Provide training;
- Require that staff annually submit certifications regarding outside businesses, outside employment, and volunteer positions;
- Record a certification of attendance at trainings; and
- Follow up with annual refresher sessions.

3. Create Procedures to Document Compliance

Conflict-of-interest policies and procedures should describe how conflicts will be handled. When a conflict or potential conflict of interest exists, the person with the conflict should advise the board or management committee in writing and seek guidance on how to resolve the conflict. Conflict-of-interest notifications usually include:

- The person's name, position, phone number and address;
- Details of the nature of the conflict of interest, (perceived, apparent, or actual);
- Date of notification; and
- Requested action to address the conflict of interest (recusal, exemption request, etc.).

The notification and subsequent actions should be recorded in minutes of board or management meetings. Record-keeping best practices includes documenting:

- Conflict-of-interest notifications;
- Cases of failure to disclose;
- Disclosure by others (for example colleague or member of the public);
- Reviews or investigations of alleged conflicts;
- Assessment of the matter and how it was considered;
- Action taken or resolution; and
- Annoying or trivial claims.

4. Implement the Regulations

Often people are unaware that their activities are in conflict with the best interests of the organization. A goal should be to raise awareness, encourage disclosure and discussion of issues that may constitute a conflict, and constantly encourage a "culture of candor."

Leadership and culture are important aspects of compliance. Boards or leaders should establish a culture of compliance and honesty and encourage disclosure by establishing a protocol for staff to self-report possible conflicts, raise suspected conflict-of-interest issues, or ask for guidance, without fear of retaliation. Leadership should appoint an individual or office to ensure conflict-of-interest rules are implemented and followed. However, the protocol should not rely solely on voluntary compliance, but also on procedures to allow grantees and subrecipients to report and have independent checks made to ensure that conflicts do not exist.

Monitoring is a best practice that entails having someone review the names of the principals of businesses that may become subrecipients, contractors or suppliers to determine whether there are apparent or real conflicts of interest with staff or agents of the awarding entity or pass-through entity. Many organizations circulate a questionnaire each year (usually in conjunction with training) to find out whether any board member, officer, or employee has a conflict of interest. Typically, the questionnaire asks them to disclose existing conflicts and reminds them to disclose any that may crop up in the future.

Monitors should also determine whether subrecipients have conflicts of interest in the sub-awards and contracts by asking them to disclose the names of their immediate family and business partners and those of the principals of the organizations and contractors with which they transact grant project business.

The primary goal in managing conflicts of interest is to ensure that as decisions are made, they are seen to be made on proper grounds, for legitimate reasons, and without bias or unfairness.

5. Know the Consequences.

Violating conflict-of-interest rules can have serious consequences for a grant program. Bad publicity surrounding undisclosed conflicts may seriously undermine the public trust in the program as well as damage personal reputations. Audits and investigations can result in the grantee's having to repay Federal funds, or individuals being fired or prosecuted.

A Conflict of Interest Can Lead to Criminal Actions

In some cases, conflicts of interest can lead to criminal prosecutions. It's not that the conflict of interest itself is a criminal act, but it can lead to other acts, such as deliberately hiding relationships, financial gains or other advantages through false statements, misrepresentations, or filing false documents, which are crimes. With such personal risk at stake, it is easy to see why disclosures of conflicts of interest are so important.

Example of a Prosecution Resulting from a Conflict of Interest

- A former planning commissioner and her ex-boyfriend were convicted on Federal corruption charges. The pair took part in a scheme in which she steered more than $2 million in contracts and loans to him. She got the agency to award a computer contract to a former boyfriend's company. The contract, which started at $8,900, escalated to about $1 million over 5 years. The former planning commissioner did not reveal details of her personal relationship with the ex-boyfriend and helped keep his name off the contracts his company received. She knowingly hid the conflict of interest and personally benefited from her actions. As a result, she and her ex-boyfriend were convicted. Sentencing is pending.

If you have knowledge of possible fraud, promptly report it to your local HUD Office of Inspector General (OIG) or online to the OIG hotline on OIG's Web site at https://www.hudoig.gov/report-fraud.

6. Request an Exception

HUD may grant an exception to non-procurement conflicts of interest on a case-by-case basis. It is the recipient's responsibility to submit a written request for an exception to its local HUD CPD office. When submitting a request, the recipient must provide the following documentation as threshold requirements for consideration:

- A public disclosure of the conflict (include how the disclosure was made); and
- An opinion of the recipient's attorney that the exception does not violate State or local law.

HUD determines whether threshold requirements are met and whether the circumstances fall within exception criteria permitted by the regulations. Remember that submitting a request does not authorize a recipient to engage in any activity or enter into any contract that constitutes a conflict. You may proceed only after you receive the approval in writing from HUD.

7. Get Help

Conflict-of-interest requirements are often nuanced and must be reviewed case by case. HUD provides assistance when conflict-of-interest situations arise or are in question. You can get help from your local CPD office when such issues arise.

Bottom line:
Conflicts of interest are situations not allegations…
BUT they must be disclosed and managed properly.

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"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.