
AUDIT REPORT



MINNEAPOLIS PUBLIC HOUSING AUTHORITY SUPPLEMENTAL POLICE SERVICES

MINNEAPOLIS, MINNESOTA

2004-CH-1003

APRIL 14, 2004

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



Issue Date	April 14, 2004
Audit Case Number	2004-CH-1003

TO: Diane Cmiel, Director of Public Housing Hub, 5KPH

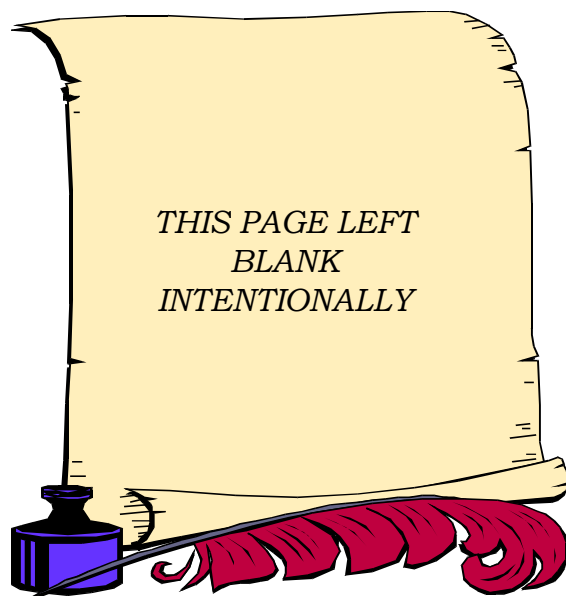
FROM: 
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Minneapolis Public Housing Authority
Supplemental Police Services
Minneapolis, Minnesota

We completed an audit of the Minneapolis Public Housing Authority's supplemental police services. We initiated the audit based on a citizen complaint to our Office. The complainant alleged that the Authority did not conduct its procurement of supplemental police services through full and open competition. Our audit objectives were to determine whether the complainant's allegation was substantiated and HUD's rules and regulations were followed. Our specific objectives were to evaluate the effectiveness of the Authority's procedures and controls over contract awards, contractor performance, and contract payments. The audit resulted in three findings.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Thomas Towers, Assistant Regional Inspector General for Audit, at (313) 226-6280 extension 8062 or me at (312) 353-7832.



Executive Summary

We completed an audit of the Minneapolis Public Housing Authority's supplemental police services. We initiated the audit based on a citizen complaint to our Office. The complainant alleged that the Authority did not conduct its procurement of supplemental police services through full and open competition. Our audit objectives were to determine whether the complainant's allegation was substantiated and HUD's rules and regulations were followed. Our specific objectives were to evaluate the effectiveness of the Authority's procedures and controls over contract awards, contractor performance, and contract payments—with the focus on supplemental police services contracts. Throughout the report we use the term supplemental police services to describe private security guard services, police services contracted directly between the Authority and the Minneapolis Police Department, and services provided by off-duty police officers, procured by the Authority for the safety and security of tenants residing in their housing units.

Supplemental police services contracts were generally awarded through full and open competition, but contracts were not always executed or renewed on time. Improvements were also needed in the administration of supplemental police services and controls over contractor payments. During our audit, we determined that the Authority failed to: (1) adequately support \$1,119,274 paid to off-duty police officers; (2) consistently follow Federal requirements and its procurement policies in the administration of supplemental police services contracts; and (3) consistently implement effective controls to prevent overpayments of \$268,349 that included overpaid sales taxes (\$260,923) and duplicate invoices (\$7,426).

Payments To Off-Duty Police Officers Were Not Adequately Supported

The Authority failed to adequately support \$1,119,274 paid to off-duty police officers. The payments were also made without a written agreement outlining the supplemental police services at seven of the Authority's housing projects. Although the Authority received invoices, it lacked weekly timesheets to substantiate the amounts paid or hours worked. In addition, we found inconsistencies in the number of hours claimed and the hourly pay rates in some instances where the Authority provided documentation.

The Administration Of Supplemental Police Services Contracts Needed Improvement

The Authority did not consistently adhere to its procurement policy or Federal requirements for administering procurement contracts. Specifically, the Authority did not always: (1) execute contracts (in lieu of purchase orders) or renew contracts on time; (2) obtain Board approvals when required; (3) ensure its contract award recommendations were independently reviewed; (4) prepare independent cost estimates prior to obtaining quotes; (5) disburse funds in accordance with prescribed procedures; and (6) adequately

document contractor performance related to the terms of the contract.

Controls Over Contractor
Payments Needed
Improvement

The Authority's controls over contractor payments needed improvement. Specifically, the Authority did not always ensure: (1) payments to contractors were made according to contract terms; (2) contract administrators' duties were properly segregated; (3) requests for checks were properly used; and (4) contract obligations were sufficient to cover all invoice payments. These weaknesses resulted in the Authority mispending \$268,349 in HUD funds. During our audit, the Authority's management implemented corrective actions to address some of these deficiencies.

Recommendations

We recommend that HUD's Director of Public Housing Hub, Minneapolis Field Office, assure that the Authority reimburses its appropriate HUD Program for the inappropriate use of funds and implements controls to correct the weaknesses cited in this report.

We presented our draft audit report to the Housing Authority's Executive Director, the Board of Commissioners' Chairperson, and HUD's staff during the audit. We held an exit conference with the Authority's Executive Director on January 6, 2004. The Authority disagreed that HUD funds were inappropriately used.

Table Of Contents

Management Memorandum	i
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Executive Summary	iii
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Introduction	1
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Findings

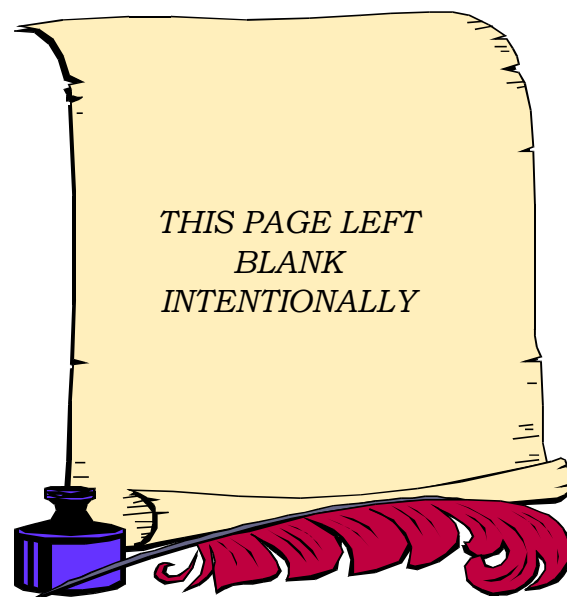
1. Payments To Off-Duty Police Officers Were Not Adequately Supported	5
2. The Administration Of Supplemental Police Services Contracts Needed Improvement	13
3. Controls Over Contractor Payments Needed Improvement	25

Management Controls	37
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Follow-Up On Prior Audits	39
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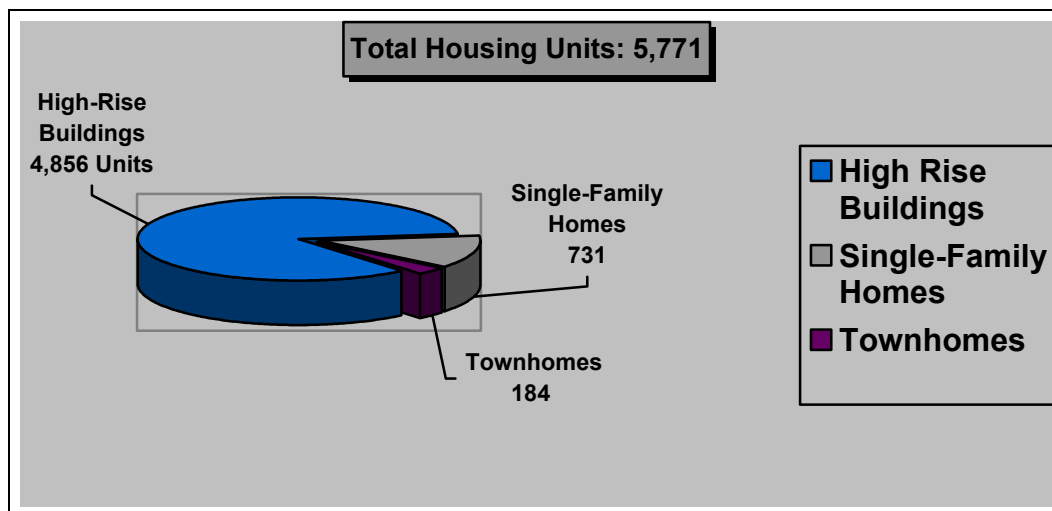
Appendices

A Schedule Of Questioned Costs	41
B Auditee Comments	43
C HUD Comments	67



Introduction

The Minneapolis Public Housing Authority was established under the laws of the State of Minnesota. The Authority contracts with HUD to provide eligible individuals and families in Minneapolis, Minnesota with decent, safe, and affordable housing. The Authority is the largest in Minnesota and the 25th largest in the country. The Authority manages nearly 5,800 housing units, which include 4,856 units (40 high-rise buildings), 731 single-family homes, and 184 townhomes.



In addition to providing housing services, the Authority also provides its residents with a variety of services and programs. These include assisted living programs for elderly adults; Head Start programs; economic self-sufficiency and employment programs; and security and drug prevention programs that use the services of the Minneapolis Police Department, private security contractors, and off-duty police officers. The Authority spent over \$17 million, including \$1,259,209 in payments to off-duty police officers, to fund its supplemental police services. The Authority used \$11,983,491 (about 69 percent) of HUD funds to pay for these services, using a combination of the Capital Fund Program (formerly Comprehensive Grant Program), Public Housing Operating Subsidies, and Public Housing Drug Elimination Program.

A nine-member Board of Commissioners governs the Housing Authority. Cornell Moore is the Chairperson of the Board of Commissioners, and Cora McCorvey is the Executive Director of the Authority. The Authority's official books and records are maintained at 1001 Washington Avenue North, Minneapolis, Minnesota.

Audit Objectives

The audit resulted from a citizen complaint to our Office. The complainant alleged that the Authority awarded supplemental police services contracts without full and open

Audit Scope And Methodology

competition. Based on the complaint, our objectives were to determine whether the complainant's allegation was substantiated and HUD's rules and regulations were followed. Specifically, we evaluated the effectiveness of the Authority's procedures (with an emphasis on supplemental police services contracts) for: (1) awarding contracts; (2) monitoring contractor performance; and (3) making payments to contractors

We conducted the audit at HUD's Minneapolis Field Office and the Authority's Office. We performed our on-site audit work from January 2003 through August 2003.

Our scope covered the Authority's procurement activities over supplemental police services contracts for the period January 1, 1996 through December 31, 2002. The period was adjusted as necessary. We conducted the audit in accordance with Generally Accepted Government Auditing Standards.

To accomplish our audit objectives we interviewed: HUD's staff; the Authority's former and current staff; the complainant; the complainant's legal counsel; former and current police officers of the Minneapolis Police Department; and two State of Minnesota auditors.

Additionally, we reviewed the following:

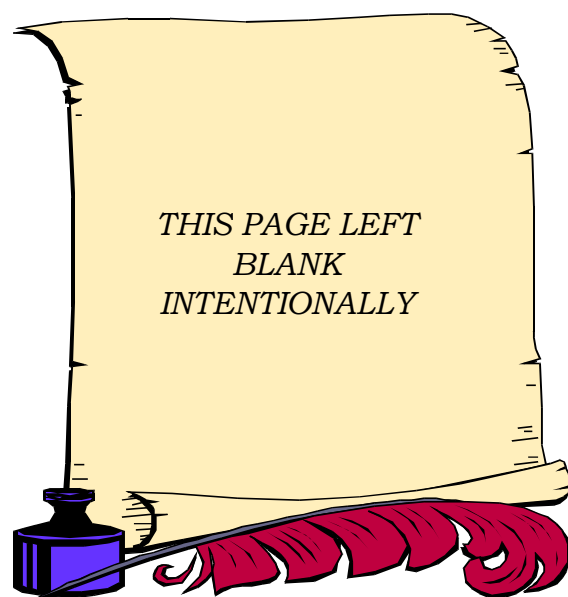
- Parts 85 and 761 of Title 24 of the Code of Federal Regulations;
- HUD Handbook 7485.3;
- HUD's files for the Authority;
- Office of Management and Budget Circular A-87;
- General Accounting Office's Assessing Internal Controls in Performance Audits; and
- Authority's security contractor payments; Security Guard Requests for Proposals; supplemental police services procurement files; Procurement Procedures Manual (dated March 22, 1995 and revised January 9, 2003); timesheets, invoices and check requests provided by the Authority and the Minneapolis Police Department for one of the contractors; Board meeting minutes; Annual Contribution Contract; organizational chart; Public Housing Drug Elimination Program agreement with HUD; Moving To Work Demonstration

Program agreement with HUD; the Cooperative Agreement between the Authority and the City of Minneapolis; payroll and other records obtained from the complainant's legal counsel; an affidavit of the former Deputy Executive Director; and Audited Financial Statements for Fiscal Years 1996 through 2002.

We used Computer Assisted Audit Techniques, including ACL, to analyze: (1) the Authority's contract register; (2) payments made to off-duty officers and security contractors; and (3) selected samples for audit. We did limited tests of the reliability of computer-processed data by corroborating information through reviews of contract files, and verification with the Authority's staff.

Using ACL, we performed reasonableness tests on 9,179 (100 percent) contract/purchase order transactions recorded in the Authority's contract register as of January 28, 2003. Additionally, we used ACL to analyze 5,472 (100 percent) payment transactions to off-duty officers for determining hourly rates and total compensation per officer. We also selected 20 of 811 payment transactions made to three security contractors and the local law enforcement agency between August 1, 1996 and December 31, 2002. In selecting our sample, we stratified the population by contractors and selected a test sample size of five from each stratum. From this sample, we were able to determine, through extrapolation, that the Authority made overpayments of sales taxes to two of its contractors over a 42-month period.

We provided a copy of this report to the Housing Authority's Executive Director and the Chairperson of the Board of Commissioners.



Payments To Off-Duty Police Officers Were Not Adequately Supported

The Minneapolis Public Housing Authority paid \$1,259,209 in HUD funds to off-duty police officers without executing a written agreement or having adequate support for expenses incurred between February 1999 and December 2000. This occurred because the Authority's former Deputy Executive Director approved the use of check requests to respond to an emergency situation. However, the use of check requests continued for 22 months without a written agreement being executed. As a result, the Authority lacked assurance that the invoiced services were for reasonable and necessary expenses, and failed to maintain adequate documentation in support of \$1,119,274 in payments to off-duty police officers.

Federal Requirements

Part A, Section 15(A) of the Annual Contributions Contract between HUD and the Housing Authority requires the Authority to maintain complete and accurate records. Section 5 of the Contract requires the Authority to operate its project in compliance with Federal requirements such as HUD's regulations and Office of Management and Budget Circulars. Office of Management and Budget Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, Attachment A, paragraph C(1)(j) provides that costs must be adequately documented in order to be allowable under Federal awards.

24 CFR Part 85.20(b)(6) requires that accounting records be supported with source documentation, such as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub grant award documents.

24 CFR Part 761.15(b)(1)(ii)(C), revised April 1, 1999, states if a local law enforcement agency is receiving funds from the Authority, the Authority and the agency are required to execute a written agreement. The agreement must describe the activities to be performed by the agency, their scope of authority, how they will coordinate their activities, and the types of activities the agency is expressly prohibited from undertaking. These same requirements were reiterated in 24 CFR Part 761.17(a)(1)(ii)(C), revised as of April 1, 2003.

HUD Handbook 7485.3 G, Appendix 2.1, Comprehensive Grant Program Guidebook, paragraph 4(e) requires the

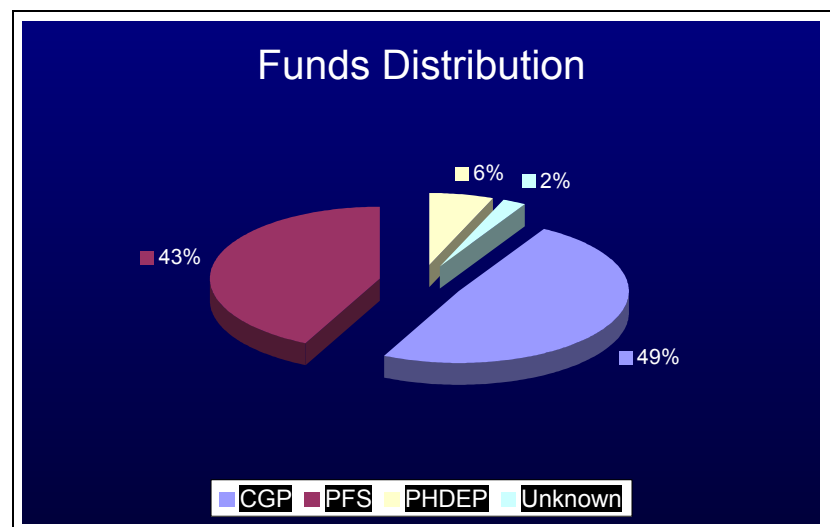
Authority to execute a long-term law enforcement service agreement (over and above local law enforcement baseline services) with the primary law enforcement provider (local police, sheriff, and/or State). Paragraph (4)(h) states the Authority will not incur expenditures until it and the local law enforcement agency execute a contract for the additional law enforcement activities.

Authority's Procurement Policy

The Authority's Procurement Procedures Manual dated March 22, 1995, revised October 26, 2000, and VI Section C of the Authority's Procurement Procedures Manual states the Authority is required to execute a written agreement for professional services over \$25,000. Prior to October 26, 2000, a contract was required for professional services over \$10,000.

Source Of Funds For Paying Knight Security

The Authority paid \$1,259,209 in HUD grant funds to Knight Security and to 146 off-duty Minneapolis police officers from February 1999 through December 2000. The Authority used \$616,886 of HUD's Capital Fund Program (formerly Comprehensive Grant Program), \$538,697 in Operating Reserves (Performance Funding System), \$75,240 in Public Housing Drug Elimination Program funds, and \$28,386 in other unidentified funds.



Legend: Comprehensive Grant Program (CGP); Performance Funding System (PFS); Public Housing Drug Elimination Program (PHDEP)

Written Agreement Not Executed As Required

The Authority treated its procurement of supplemental police services as professional services, to provide greater assurance of obtaining quality services. However, the

Authority did not execute a written agreement with Knight Security for supplemental police services in accordance with Federal requirements and the Authority's procurement policies.

Instead, supplemental police services were provided over a 22-month period based on a verbal agreement between the Authority's former Deputy Executive Director and a Minneapolis Police Department Sergeant. The Police Sergeant was the former Housing Police Team Supervisor for the Authority and later represented Knight Security.

Services Were Obtained
To Address An
Emergency Situation

According to the Authority's former Deputy Executive Director, the Authority became concerned about increased criminal activity in several of its housing projects in early 1999. The Deputy Director said he made a verbal agreement with a Police Sergeant to use off-duty police officers from the Minneapolis Police Department. He did this because the Police Department could not provide additional police officers, and the use of unarmed guards in high-rise buildings was insufficient. When the off-duty police officers were brought into the Authority's housing projects to patrol at night, the former Deputy Executive Director said it was viewed as an emergency situation requiring quick action on behalf of the Authority in response to increased criminal activity.

Originally, the Authority made payments to Knight Security from February through March 1999, and from these payments, the Police Sergeant wrote checks to each off-duty officer. Beginning in April 1999, the off-duty officers were paid directly by the Authority.

Under the terms of the verbal agreement, check requests were used by the Police Sergeant to pay the off-duty police officers and the Authority's former Deputy Executive Director approved the payments. According to the Authority's Procurement Procedures Manual, check requests should be initiated in lieu of other methods of procurement when deemed prudent and approved by the Authority's Executive Director or its Director of Finance. The manual included examples such as payments for attending meetings, out-of-town travel, certain subscriptions, and stipends for Commissioners. The Authority's Director of Finance said approval of the off-duty officers' check requests was an oversight and the

Authority Lacked
Assurance That Costs Were
Reasonable And Necessary

Authority stopped this practice after HUD-OIG auditors addressed the issue with them. The Authority implemented new procedures during the audit to correct this deficiency.

As a result of having a verbal agreement with Knight Security, the Authority lacked assurance that all invoiced services were for reasonable and necessary expenses. For example, for over 40 pay periods between March 1999 and December 2000, three off-duty police officers worked more than 24 hours a week for Knight Security while working full time as officers of the Minneapolis Police Department. One of the three officers—the Police Sergeant in charge of Knight Security—claimed 3,627 hours of work, or about 38 hours per week during the 22-month period while working as a full-time officer with the Minneapolis Police Department. Working both jobs, we estimated that the Police Sergeant worked an average of 11 hours a day—seven days a week—for 22 months, and earned \$178,377 from Knight Security.

Payments Lacked Adequate
Support

The Authority used at least \$1,119,274 in HUD's funds to pay Knight Security and its officers without maintaining adequate support. The Authority was unable to provide timesheets and/or sign in sheets to substantiate all of the services received.

For the period February 1999 to December 2000, the Authority furnished 12 of 95 invoices containing supporting documentation such as summary timesheets showing total daily hours worked by each officer, amounts paid, and the locations worked. Neither the Authority nor the Police Sergeant could provide documentation to support the remaining 83 weeks of billed services. The Police Sergeant said he was not required by the Authority to submit timesheets showing daily totals by officer, and kept them only for about two to three months in case the officers had questions about their pay.

We determined that the Authority paid Knight Security a total of \$1,259,209 for services received from February 1999 through December 2000. A total of \$7,426 represented duplicate payments that we addressed in Finding 3, leaving a balance of \$1,251,783. We reviewed the 12 weekly payroll summary worksheets provided by the Authority and determined that \$132,509 of the payroll was

adequately supported. As a result, the Authority did not have assurance that the remaining HUD funds totaling \$1,119,274 (\$1,251,783 less \$132,509) to Knight Security were for reasonable and necessary expenses. This amount represents unsupported expenses that should be reimbursed to the Authority's appropriate Programs.



Auditee Comments

[Excerpts paraphrased from the Housing Authority's comments on our draft finding follow. Appendix B, pages 4 to 6, and 12 to 17 contain the complete text of the Authority's comments for this finding.]

While the Housing Authority did not have a formal written contract with Knight Security, the contract was based upon Knight's written proposal, the weekly invoices, check requests and the course of dealing between the parties.

The lack of a formal written contract and the use of check requests did not result in a lack of adequate controls over the rates charged for the off-duty police officers as suggested in the audit report. The Authority agrees that it should have had a formal written contract and should not have used check requests to pay for off duty police services. However, Knight Security's written proposal clearly stated the regular hourly rate is \$23 per hour and the holiday rate is \$33 per hour.

Payments to off-duty police officers are adequately supported and are eligible Federal costs. The Authority respectfully requests that the Office of Inspector General revise its report to delete the recommendation that the Authority should reimburse the appropriate HUD Program from non-Federal funds in the applicable amount. This request is based upon: a) the admitted need and success of the off-duty police service; b) the fact that in 99.93% of the time, the Authority paid the officers an hourly rate of \$23 or \$33; c) the clear language in 24 CFR 85.20 (b)(6) which is misquoted in the report; and d) the payment documentation provided to support the police services.

The Authority believes that its limited and dwindling resources are best used to implement the changes that the OIG has recommended and to continue to provide quality housing for low-income persons.

OIG Evaluation Of Auditee Comments

In the absence of a formal written contract, we looked for support in the form of timesheets documenting the hours, days and locations certified as worked by each of the off duty police officers. In instances where the Authority provided this documentation, we excluded the appropriate amounts from our unsupported figure. In all other instances where the Authority only had check request invoices, we determined that this was not adequate since daily hours—by location and officer—were not provided. Additionally, without a formal contract we did not know what specific services were to be provided or the locations to be covered by the off duty police officers.

We did not misquote 24 CFR Part 85.20(b)(6) in our report. In the report we stated that 24 CFR Part 85.20(b)(6) requires that accounting records be supported with source documentation, such as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub grant award documents. In 24 CFR Part 85.20(b)(6) under the section Source Documentation, it states that accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub grant award documents, etc."

The Authority indicated that it based its payments on Knight Security's proposal. However, as stated in Knight's deposition, there were several items in its proposal that were never performed such as monitoring all the buildings listed in the proposal, or performing all of the listed tasks. As such, the proposal contained suggestions that were never formalized in a written contract.

The Authority said we concluded that "summary timesheets" were mandatory "to substantiate the amounts claimed or hours worked." We interpreted the timesheets to be synonymous with time and attendance records. The Authority indicated that they produced cancelled checks and paid bills, items that are clearly listed in the CFR as adequate documentation. The Authority also said that these paid bills were made up of weekly invoices showing the number of hours worked each week by each officer; and that the invoices were similar to a weekly timesheet. We could not rely solely on the paid invoices and cancelled checks alone because in several instances we found that

hours shown as worked on paid invoices did not match the hours listed on the timesheets that were available to review. We didn't find evidence where the Authority reconciled the differences between the timesheets and the invoices.

In addition, as indicated by the Authority, the invoices showed total hours worked by location and the total hours worked by each officer. However, the invoices didn't show the hours that each officer worked at each location, by date. The timesheets had this information, and is the reason why we considered timesheets as needed documentation to support the amounts billed as reasonable and necessary expenses. Unless the Authority can provide further documentation, we recommend that it reimburse its Public Housing Program the \$1,119,274 in unsupported costs.

Auditee Comments

The Authority has complied with the recommendation to execute professional contracts for services in excess of \$25,000. The Authority's Procurement Policy and Procedures require a written contract for professional services in excess of \$25,000. This is an internal policy established by the Authority and is not required by state or Federal law. On occasion, the Authority has obtained professional services in excess of \$25,000 by purchase order to cover periods between formal written contracts and when sole source police services were obtained.

The Authority's use of purchase orders resulted in funds being used in an efficient manner. Without any basis or explanation the report concludes that the use of a purchase order results in funds not being used in an efficient manner. While the Authority agrees that it should have had formal contracts for some of the supplemental police services, the use of a formal contract has nothing to do with whether the expenditure would have been incurred. Also, awards to the private security companies resulted from a formal competitive process. In addition, contracts with the Minneapolis Police Department and off duty police officers were sole source. Clearly, the purchase orders were an efficient use of funds.

In the future, the Authority's Procurement Department will more closely monitor the procurement of professional services to require a written contract. Also, by April 2004, the Authority intends to have procedures in place so that

OIG Evaluation Of
Auditee Comments

contract awards are reviewed by the Contracting Officer before going to the Board of Commissioners for approval.

The Authority's willingness to more closely monitor the use of written contracts for professional services in excess of \$25,000 should help to improve this area. Also, the Authority's proposal to have procedures in place by April 2004 to address reviews by the Contracting Officer is responsive to our recommendation. However, the use of purchase orders for procuring professional services in excess of \$25,000 is not in accordance with its own procurement policies. We look to the use of formal contracts in these instances to provide greater assurance of receiving the best possible price for the services obtained.

Recommendations

We recommend that HUD's Director of Public Housing Hub, Minneapolis Field Office, assure the Minneapolis Public Housing Authority:

- 1A. Provides documentation to support the \$1,119,274 in unsupported supplemental police services cited in this finding. If adequate documentation cannot be provided, then the Authority should reimburse its appropriate Programs from non-Federal funds for the applicable amount.
- 1B. Executes written contracts for all professional services exceeding \$25,000 as required by HUD's regulations and the Authority's Procurement Policies and Procedures.

The Administration Of Supplemental Police Services Contracts Needed Improvement

The Minneapolis Public Housing Authority needed to improve its administration of supplemental police services. Specifically, the Authority failed to: (1) execute contracts or renew contracts on time; (2) obtain Board approvals for procuring professional services over \$25,000; (3) ensure its contract award recommendations were independently reviewed; (4) prepare independent cost estimates to determine the type of contract needed; and (5) ensure funds were reserved and obligated before obtaining services. Problems occurred because the Authority did not adequately monitor and evaluate supplemental police services contractors' performance for compliance with contract terms. Additionally, the Authority's Procurement Department lacked adequate procedures and controls for processing and administering supplemental police services contracts. As a result, the Authority was not assured that supplemental police services were consistently obtained in the most efficient and effective manner.

HUD's Requirements

Section 5 of the Annual Contributions Contract between the Housing Authority and HUD requires the Authority to develop and operate all projects in compliance with the applicable statutes, executive orders, and regulations issued by HUD, including Part 85 of Title 24 of the Code of Federal Regulations.

24 CFR Part 85.36(b)(2) requires grantees and sub grantees to maintain a contract administration system that ensures contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders. Additionally, Part 85.36(f) states grantees and sub grantees must perform a cost or price analysis in connection with every procurement action—including contract modifications—before receiving bids or proposals.

The Authority's Procurement Requirements

The Authority's Procurement Policy, dated October 26, 2000, requires the Authority to obtain Board approval for procurement of professional services over \$25,000. Prior to October 26, 2000, Board approval was required for these type contracts over \$10,000. Paragraph 8 of the Authority's Procurement Policy also requires Board approval when change orders exceed 25 percent of the initial contract in excess of \$10,000.

Section C of the Authority's Procurement Procedures Manual, dated March 22, 1995 (revised January 9, 2003) states after collecting all completed evaluations, a written memorandum must then be prepared by the contract administrator specifying the recommended selection. Such memorandum will include a copy of the Request for Proposal document and a copy of each evaluation, and will be sent to the Contracting Officer for review and approval.

Funding Sources

Between August 1996 and March 2002, the Authority disbursed \$14,977,271 for 11 contracts and \$1,136,287 for 14 purchase orders to obtain supplemental police services. The funding of \$16,113,558 included \$5,245,456 in Public Housing Drug Elimination Program funds, \$5,019,398 in Operating Funds, and \$459,428 in Capital Fund Program funds (formerly Comprehensive Grant Program). The City of Minneapolis provided the remaining \$5,389,276.

Contracts Were Not Executed Or Renewed On Time

The Authority did not timely execute or renew contracts for supplemental police services resulting in the use of purchase orders for 14 of 25 requests for services. The contract value of the purchase orders we reviewed ranged from \$45,064 to \$322,779.

The Authority failed to execute a 2001 Minneapolis Police Department contract resulting in the issuance of 11 purchase orders. The Authority's Director of Resident Initiatives said analyzing the contracts was a tedious process. The Authority had to make sure that the language of the contract allowed it to make immediate decisions based on various situations that can arise, such as changes in the level of crime.

In 2000, the Authority also failed to renew three guard contracts (contract numbers 20.25A, 20.25B and 01.42) on time. In these instances, except Guard Contract Number 01.42, the Authority used purchase orders to cover the periods without a contract after the previous contract expired. The Authority did not execute Contract Number 01.42 until February 2002, eight months after the Board approved the contract award recommendation in June 2001. The Assistant Director of Property Management said the contractor's union got involved—thereby delaying the contract in Legal Services.

The Authority's Procurement Officer said the untimely renewal of contracts was an ongoing problem. The Officer attributed some of the delays to the Authority's Legal Department, and to the lack of urgency on the part of the Procurement Department since they knew that services could continue with the issuance of purchase orders.

In July 2003, HUD's Public Housing staff at the Minneapolis Field Office questioned the validity of using purchase orders in lieu of having a contract in place, where a contract was required. In HUD's opinion, services should have ceased until a contract was in place. The Authority lacked procedures and controls to alert them when a contract was approaching the point where it needed to be renewed so that ample time was available. 24 CFR Part 761.15(b)(1)(i), Subpart B—Use of Grant Funds, prohibits the expenditure of HUD funds without executing a written agreement. The timely renewal of contracts will prevent any potential service interruptions and preclude the need for using purchase orders in place of contracts.

Board Approvals Were Not Obtained

The Authority did not obtain Board approvals for 22 of 25 requests for supplemental police services reviewed. As previously mentioned, 14 were purchase orders instead of contracts because the Authority either failed to execute a contract or renew existing contracts timely. The remaining eight items were contracts. Five contracts had a contract term of one year that was renewable for another year. Board approval was not obtained on these five contracts because the Authority's Contracting Officer said it was not necessary to obtain the Board's approval to renew the contracts for a second year. The Purchasing Supervisor was unable to explain the reason why Board approval was not obtained on the remaining three contracts.

The Authority's Contracting Officer said the Board's initial authorization gave the Authority permission to renew a vendor's contract after the first year to complete the two-year term. However, the contracts each had change orders in excess of 25 percent of their initial contract price exceeding \$10,000. Therefore, Board approval was required for the second year of each of these contracts, in accordance with the Authority's Procurement Policy.

Contract Award
Recommendations Were
Not Independently
Reviewed

The Authority did not follow its contracting procedures requiring the Contracting Officer to review the Selection Committee's award recommendations before sending them to the Board for approval.

The Authority's Contract Administrator submitted recommendations directly to the Board on all seven security guard contracts reviewed rather than to the Contracting Officer. The Contracting Officer said the Authority was not following its contracting procedures and said the Purchasing Supervisor reviewed the evaluation documentation after it went to the Board. The Contracting Officer also said the Authority was taking action to change its process to ensure that evaluation documentation is reviewed first before being sent to the Board for approval.

Independent Cost
Estimates Were Not
Properly Documented

The Authority did not maintain documentation to support its basis for estimating contract costs to determine whether bid prices were reasonable—in accordance with 24 CFR Part 85.36(f). An independent cost estimate is a required contracting procedure because it will determine the type of procurement method to be used, and will help to determine the reasonableness of bids or proposals received. It is also useful in ensuring an appropriate amount of funds are obligated for budget purposes.

The Authority entered into 11 security contracts between August 1996 and March 2002 at a cost of \$16,695,340. The Authority could not provide a basis to show how it assessed the reasonableness of the contractor's bid price on any of these contracts. For instance, although the Authority's records indicated the total projected hours on seven guard contracts, we could not determine how the projected hours were estimated. The Assistant Director of Property Management and Security Guard Contract Administrator indicated the Authority had cost estimates, but could not explain how the estimated costs were arrived at.

Moreover, the Authority had four police contracts that required a cost analysis according to 24 CFR 85.36(f) since they were procured non-competitively. Although the contract files contained budget information verifying the contract price, a cost analysis was not done to determine if the Authority obtained these services at a reasonable price.

HUD Funds Were Not Properly Reserved And Obligated

The Authority did not properly reserve and obligate \$989,829 of its HUD funds to ensure sufficient funds were available to cover the expenses before obtaining the services.

The Authority did not follow HUD's procedures because it disbursed its grant funds as expenses were incurred. HUD Handbook 7460.8, Procurement Handbook for Public and Indian Housing Authorities, requires Housing Authorities to have a process for setting aside funds prior to making purchases—to assure that funds are available. Of the 25 items reviewed, 11 purchase orders were issued to pay for services already rendered. For example, the Authority's Contracting Officer approved purchase order 94337 on September 10, 2001, 48 days after the vendor's invoice date of July 24, 2001. Purchase order number 94337 was for services rendered in June 2001. Based on this payment arrangement, funds were not set-aside before the expenses were incurred as required by HUD.

The Authority's Director of Legal Services said the reason the purchase orders were used was to continue security services while the 2001 contract with the Minneapolis Police Department was being renewed. However, the Authority should have ensured that appropriate funds for the services were reserved and obligated before issuing the purchase orders. Without appropriately reserving and obligating funds before incurring an expense, the Authority could potentially obligate itself to pay for services without having the required funds. The following table shows the purchase order number, invoice date, and the dates the 11 purchase orders were obligated.

<i>Purchase Order Number</i>	<i>Invoice Date</i>	<i>Purchase Order Issue Date</i>	<i>Difference Between Purchase Order and Invoice Dates</i>	<i>Remarks</i>
93853A	03/30/01	04/05/01	6 days	January & February 2001 Services
94165*	06/14/01	06/18/01	4 days	May 2001 Services
94176*	05/09/01	06/19/01	41 days	March 2001 Services
94177*	05/15/01	06/19/01	35 days	April 2001 Services
94337	07/24/01	09/10/01	48 days	June 2001 Services
94341	08/22/01	09/12/01	21 days	July 2001 Services
94469*	09/27/01	10/17/01	20 days	August 2001 Services
94530*	10/17/01	10/30/01	13 days	September 2001 Services
94625*	11/14/01	12/04/01	20 days	October 2001 Services
94750*	12/24/01	01/14/02	21 days	November 2001 Services
94911	02/04/02	03/13/02	37 days	December 2001 Services

Legend: *Confirming Purchase Order - a purchase order issued before a requisition form is approved.

Security Guard Contractors Were Not Effectively Monitored

The Authority did not effectively monitor its security guard contractors and evaluate their performance to ensure compliance with contract terms as required by 24 CFR 85.36(b)(2).

According to the Authority's Assistant Director of Property Management and the Security Guard Contract Administrator, the Authority conducted regular meetings with its security guard contractors as its primary method of monitoring. The Contract Administrator said that issues and concerns about guard performance were addressed during these meetings. However, the meetings were not a sufficient means of monitoring whether the contractors complied with the terms and requirements listed in their contracts. The meeting minutes did not indicate how the Authority evaluated the security contractors' overall performance.

Supplemental police services contractors were required by their contracts to submit daily and weekly reports, and ensure their guards had criminal background/history checks and were properly trained before reporting for duty. Documentation furnished by the Authority did not adequately support that the contractors completed required reports,

background checks, and training in accordance with contract specifications. The Authority's Assistant Director of Property Management and the Security Guard Contract Administrator said the Authority lacked a formal process for evaluating contractor performance, and had not done a good job in documenting problems with the security contractors.

Auditee Comments

[Excerpts paraphrased from the Housing Authority's comments on our draft finding follow. Appendix B, pages 10, 12, and 17 to 21 contain the complete text of the Authority's comments for this finding.]

Federal requirements allow discretion on the method and degree of analysis in performing a cost or price analysis. The report states that the Authority did not have supporting documentation on how the projected hours for private security guard vendors were estimated, or how the corresponding dollar amounts were determined. The Authority estimated the number of hours based upon the hours incurred at the time of the request for proposal plus some additional hours to allow for discretion in increasing the number of hours. The estimated number of hours was then multiplied by the hourly rate. In addition, the cost of police officers and off-duty police services are a sole source and are dependent upon the established hourly rates of the officers. Based upon this information and taking inflation into consideration, the Authority had the basis for a cost or price analysis.

In response to the report, the Authority has modified its Request for Solicitation form to formally document the cost estimate for goods and services prior to the solicitation of a formal contract. Also, the Authority will continue to evaluate its processes and forms for informal procurement.

OIG Evaluation Of Auditee Comments

The Authority's proposed actions appear to be responsive to our recommendation for conducting independent cost estimates prior to bid solicitation on all future contracts. For the private security guard and police services contracts we reviewed, the Authority was unable to support how they arrived at the number of hours required per contract, other than to use the hours already incurred from existing contracts. This assumes that those contracts were using resources in the most efficient manner. By modifying its Request for

Solicitation form to formally document the cost estimate prior to solicitation, this should serve as a good basis for making comparisons to bids received.

Auditee Comments

The Authority has taken and will take action to timely execute and renew contracts. The Authority denied that the delays in signing and renewing contracts were due to the Legal Department or lack of urgency on the part of the Procurement Department. Also, the Authority clarifies that the Director of Resident Initiatives did not state that contracting is tedious and may have said extensive.

The Authority agrees that some less needed services may be temporarily halted until a written contract is signed. But supplemental police services are extremely important and should not be temporarily halted. It is poor management and a narrow-sighted interpretation of Federal regulation to require every Public Housing Authority in every instance to discontinue a service because a written contract is not in place. The Minneapolis Public Housing Authority has improved its procurement procedures and respectfully requests the option to use purchase orders in some cases.

The Authority is reorganizing its Procurement Department. As a result of the reorganization, it has instituted a procedure whereby the Procurement Department provides a monthly report to the Deputy Executive Director on the upcoming deadlines to extend contract dates, or limits of authority, or to re-solicit. The Authority's goal is to have new contracts in place by the time the old contract expires, and to reduce the use of purchase orders between contracts.

**OIG Evaluation Of
Auditee Comments**

The Authority's proposed corrective actions to alert its Deputy Executive Director on upcoming deadlines so that new contracts can be put in place in a timely manner will help to improve this condition. And, we recognize that there are some circumstances that warrant the use of a purchase order to ensure continuity of services when a contract cannot be executed in time. However, this should only occur in rare situations.

Auditee Comments

The Authority is confident with the reorganization of the Procurement Department that in the future the Board will approve all professional service contracts in excess of \$25,000.

The Authority revised its Procurement Policy on April 24, 2002 and intended that a change order increasing the first year of the contract up to 25 percent would not require Board approval. The Authority also intended that such a change order would not require it to obtain Board approval to extend the contract for a second year if the Board's initial authorization permitted the Authority to renew a contract for a second year. Also, the Authority intended that it could increase the second year of the contract up to 25 percent without Board approval. The Authority will amend its Procurement Policy and Procedures and Attachment A to reflect the intent described above.

The Authority also estimates that by April 2004, it will have procedures in place so that contract awards are reviewed by the Contracting Officer before going to the Board of Commissioners for approval.

The Authority has procedures to reserve and obligate funds prior to expenditure, and retrained staff in April 2003 to improve compliance with the procedures. The Authority has taken steps to reserve and obligate funds prior to expenditure. The report states that the purpose of obligating funds prior to incurring an expense is to make sure that the Authority has sufficient funds to pay for the services. The Authority notes that it has consistently balanced the budget, receives outstanding scores under the financial indicator according to HUD's Public Housing Assessment System, and is fiscally sound.

OIG Evaluation Of Auditee Comments

The Authority's proposed improvements to its procurement procedures should help to alleviate many of the weaknesses identified during the audit. HUD should ensure that the new procedures are implemented as planned.

Auditee Comments

The Authority effectively monitored the performance of supplemental police service contracts. 24 CFR 85.36(b)(2) states that a Public Housing Authority will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions and specifications of their contracts. The Minneapolis Public Housing Authority's contract administration system for security guard vendors included daily sign in logs, daily activity logs, and incident reports that its staff reviewed daily. If there were insufficiencies in the reports, these matters were immediately resolved. The Authority determined whether a

guard was properly trained by the way the guard completed the various logs and reports.

The Authority attended monthly Security Advisory Committee meetings with staff, tenants, members of the Minneapolis Public High Rise Resident Council, and vendors to discuss and resolve security issues. The Council prepared the minutes of the meetings. In addition, the Authority communicated with the vendors in person, by phone and e-mail on a daily basis; and routinely met with each vendor on a weekly basis except for several months towards the end of the 2000 contract with Reco Security and Safety Consultants, Incorporated.

The Authority reviewed videotapes of guards on duty to determine whether they were on post or attending to duties while on post. On several occasions when the Authority determined that a guard was not performing, it asked the vendor to remove the guard from the Authority's account.

The Authority also reviewed invoices and subtracted time for missed or late shifts. Staff, residents, and guests also completed Security Guard Complaint Forms that the Authority reviewed, investigated, and resolved. Taken as a whole, these activities were a very efficient and cost effective administration system. The report's conclusion that this administration system was faulty merely because the minutes to the monthly security advisory meetings did not state how the Authority evaluated the vendor's overall performance is baseless and unreasonable.

OIG Evaluation Of Auditee Comments

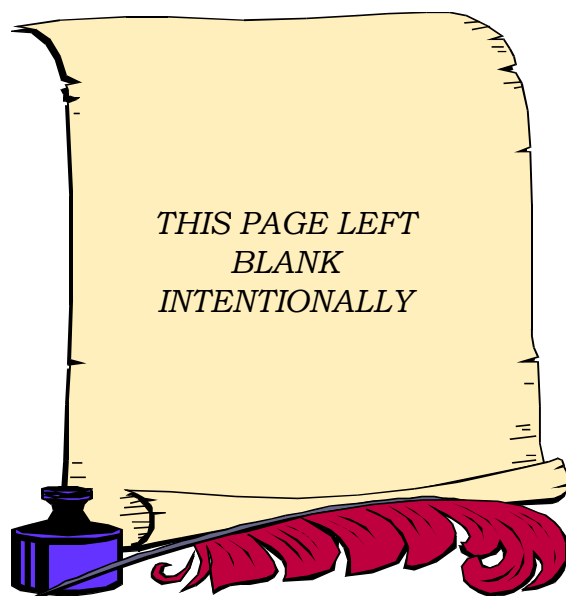
The Authority engaged in several methods of monitoring contractor's performance, as stated in their comments. However, we also recognized that improvements were needed to ensure that contractors were meeting all of the contract terms. For example, in the motion for summary judgment between the Authority and Reco Security and Safety Consultants, Incorporated, the Authority alleged that Reco failed to: 1) obtain background checks on its employees; 2) obtain mandatory training; and 3) properly supervise its employees. However, the motion was not granted because the Authority was not able to prove damages. By specifically tying performance to the terms of a contract, it becomes easier to assess damages. We want the Authority to be able to protect itself in the event of contractor nonperformance so

that compensatory damages, if needed, can be assessed and potentially recovered.

Recommendations

We recommend that HUD's Director of Public Housing Hub, Minneapolis Field Office, assure the Minneapolis Public Housing Authority:

- 2A. Provides documentation to support the reasonableness of the security services cited in this finding. If documentation cannot be provided, the Authority should reimburse the applicable Program (Public Housing Operating Subsidy, Public Housing Drug Elimination Program, and Capital Fund Program) the appropriate amount from non-Federal funds.
- 2B. Implements adequate procedures and controls to ensure that its contracts are administered as required by HUD's regulations and its Procurement Policy. At a minimum, ensure that contracts have: 1) timely awards; 2) Board approvals when required; 3) independent reviews of award recommendations; 4) bids evaluated against independent cost estimates; 5) sufficient funds reserved and obligated before services are obtained; and 6) documentation of performance related to the terms of the contract.



Controls Over Contractor Payments Needed Improvement

The Minneapolis Public Housing Authority inappropriately spent \$268,349 of HUD funds for sales taxes (\$260,923) and duplicate payments of invoices (\$7,426). The Authority needed to improve controls over its contractor payments for supplemental police services. Specifically, the Authority did not ensure: (1) payments were made in accordance with contract terms; (2) contract administrators' duties were properly segregated; (3) check requests were properly used; and (4) contract obligations were sufficient to cover invoice payments. The problems occurred because the Authority did not ensure payment requests were consistent with its policies and procedures, and with agreed-upon contract terms before approving invoices for payment. As a result, HUD funds were not used efficiently and effectively.

Federal Requirements

24 CFR 85.20(b)(3) states effective control and accountability must be maintained for all grant and sub grant cash and other assets.

General Accounting Office's Assessing Internal Controls in Performance Audits, Chapter 1, Specific Standards, dated September 1990, states key duties in authorizing, processing, recording, and reviewing transactions should be separated among individuals.

Section 5 of the Annual Contributions Contract between the Housing Authority and HUD requires the Authority to develop and operate all projects in compliance with applicable statutes, executive orders, and regulations issued by HUD, including 24 CFR Part 85.

The Authority's Procurement Policies And Procedures

The Authority's Procurement Procedures Manual, dated March 22, 1995 and revised January 9, 2003, Section VI A.2. states a check request should be initiated in lieu of other methods of procurement when such is deemed most prudent and approved by the Executive Director or Director of Finance. Examples of expenditures deemed appropriate are: (1) attendance at meetings as approved in advance by the Executive Director; (2) purchase of certain subscriptions (such as newspapers, magazines and publications that include intermittent updates); (3) out-of-town travel as approved, in advance, by the Executive Director; (4) mileage/parking cost reimbursement; (5) stipends for the Authority's Commissioners and its

resident's participation at meetings; and (6) payment of certain permits and taxes.

Section II of the Procedures Manual states the Executive Director is authorized to make purchases in accordance with the provisions of the Authority's procurement policies provided that sufficient budgetary authority exists to accommodate such purchases.

Security Contractors' Agreements

Contract number 96.108, between the Authority and Reco Security and Safety Consultants, Incorporated, dated August 30, 1996, item G, states the Authority will compensate the contractor at an hourly rate of \$11.74 per hour inclusive of all services to be provided. Item U of the contract further states payment will be inclusive of all costs and other expenses including 6.5 percent Minnesota sales tax as applicable.

Contract number 97.74 A, between the Authority and Avalon Security Corporation, dated May 8, 1998, item IV, states the Authority will compensate the contractor at an hourly rate of \$16.67 inclusive of all costs and expenses including Minnesota sales tax.

Contract Number 97.74 B, between the Authority and Reco Security and Safety Consultants, Inc., dated May 11, 1998, item IV states the Authority agrees to compensate the contractor for services required, performed and accepted, inclusive of all costs and expenses, including 6.5 percent Minnesota sales tax as applicable, at an hourly rate of \$16.67 per hour, pursuant to the Fee Schedule attached in Exhibit A.

Payments Were Not Made In Accordance With Contract Terms

The Authority inappropriately paid \$260,923 to two security guard contractors who billed for Minnesota State sales taxes as separate line items on the invoices.

We first identified the error in the overpayment of sales tax after randomly selecting 20 of 811 stratified invoice payments made to the Minneapolis Police Department and three private security guard contractors for the period of August 1996 through December 2002. The invoice dates of the samples selected ranged between September 1997 and April 2000.

Based on the results of our sample, we determined that eight of 20 invoices had 6.5 percent Minnesota sales taxes added to the hourly rate charged by two of the three private guard contractors. We did not find any sales tax discrepancy on the other guard contractor or the Minneapolis Police Department. The total amount of overpaid sales taxes based on our sample review was \$11,396. The following table lists the contract number, invoice number, invoice date, amount paid, billed amount, and the amount of overpaid sales tax.

<i>Contract Number</i>	<i>Invoice Number</i>	<i>Invoice Date</i>	<i>Amount Paid</i>	<i>Billed Amount</i>	<i>Amount Of Overpaid Sales Tax</i>
97.74B	1009	12/07/98	\$14,380	\$13,503	\$878
97.74B	1034	01/25/99	14,522	13,636	886
97.74B	1161	08/30/99	9,161	8,602	559
96.108	None	09/02/97	26,950	25,305	1,645
96.108	None	11/17/97	53,722	50,443	3,279
96.108	None	10/12/98	28,654	26,905	1,749
97.74A	6282699	06/28/99	19,760	18,554	1,206
97.74A	9073599	09/07/99	19,564	18,370	1,194
Totals			\$186,714	\$175,318	\$11,396

Based on this sample, we extrapolated our results to include the entire universe of payments made to the two contractors between August 1996 and April 2000. We were able to determine that the Authority paid a total of \$260,923 in sales taxes on three contracts based on total payments of \$4,014,200 times the sales tax rate of 6.5 percent ($4,014,200 \times .065$).

The Authority paid \$55,356 and \$70,208 in sales taxes to Reco Security and Safety Consultants, Incorporated on invoices for Contract 96.108 and Contract 97.74B, respectively. The Authority paid an additional \$135,359 to Avalon Security Corporation for sales taxes on Contract 97.74A. However, the three contracts already included Minnesota sales taxes in the hourly rates to be paid to the two contractors.

The Authority's Director of Legal Services said the Authority paid the contractors sales taxes separately on their invoices by mistake. The contractors were

inappropriately paid because the Authority's contract administrators did not follow the contracts' terms when approving the invoices for payment. In April 2000, upon discovering the error, the Authority took corrective action by denying all future contractor claims for sales tax as a separate line item in their invoices.

The payment of these sales taxes could have been avoided if the Authority placed more emphasis in reviewing the terms of the contracts before approving the invoices for payment.

Duties Were Not Properly Segregated

The Authority did not properly segregate duties over its procurement process. When procuring goods or services by purchase order, the Authority's contract administrators were allowed to: (1) prepare or approve purchase requisition forms; (2) determine the contractors to solicit; (3) certify the receipt of goods or services; (4) review contractors' invoices; and (5) authorize invoice payments. The contract administrators' performance of these functions provided the opportunity for the Administrators to certify the receipt of services and authorize the payment for those services. Proper accounting procedures require the adequate segregation of duties in order to provide control and assign accountability over the procurement process. The Authority appeared to have an adequate number of employees to segregate duties so that no one individual had complete control over the procurement payment process.

Twenty-five percent (\$61,271,426) of the total value of the Authority's procurement activities—from 1992 to January 28, 2003—was procured through the use of purchase orders. This represents a significant amount of funds in the control of the contract administrators—supporting the need to properly segregate their functions. The use of purchase orders represents a weakness that the Authority needs to address to assure its funds are used in the most efficient manner (See Finding 2).

Improper Use Of Check Requests

The Authority's Executive Director and its management approved and paid \$1,259,209 in expenses by check requests between February 1999 and December 2000. The former Housing Police Team Supervisor, operating as Knight Security, submitted check requests to the Authority on a weekly basis without a written agreement (See Finding

1). The payments to the off-duty officers by check requests continued until March 2003. This type of activity should have been processed as a formal contract to ensure proper authorization and accountability over the use of funds. The Authority's current Director of Finance knew about the check requests being made to the off-duty officers. However, it did not occur to the Director that this was a problem because the Authority made these payments for years and the Authority's Procurement policy was unclear in this area.

Duplicate Payments

Through the use of the check requests, the Authority inappropriately made seven duplicate payments of \$7,426 to the off-duty officers. The duplicate payments included either two invoices submitted for the same amounts for services performed the same day, or two invoices with different amounts for services performed the same day (we averaged these together to determine a duplicate amount). According to the Authority's Director of Finance, contract administrators were responsible for tracking payments to the officers, and the Finance Department controlled the invoice payments by invoice number. However, this system had a weakness since the Authority consecutively numbered each invoice with a stamp as they were received.

For example, invoice number 53386 for \$950 was approved for payment on June 14, 1999. On June 22, 1999, a duplicate payment request was submitted and it was stamped with a different invoice number. The Authority paid both invoices because of the different invoice numbers. The following table lists the pay period dates, invoice numbers, and the amount of the duplicate invoice payments made to the off-duty officers.

<i>Pay Period</i>		<i>Invoice Number</i>		
From	To	First Payment	Duplicate Payment	Amount
06/05/1999	06/11/1999	53386	53460	\$950
06/12/1999	06/18/1999	53462	53461	833
08/23/1999	08/27/1999	54323	54241	690
09/27/1999	10/01/1999	54718	54851	633
11/06/1999	11/12/1999	55359	55432	2,139
12/11/1999	12/17/1999	55745	55829	2,020
05/06/2000	05/06/2000	57655	57655	161
Total Duplicate Payments				<u>\$7,426</u>

Payments Exceeded
Contract Authority

Although the duplicate amounts we found were minimal, one remedy would be to assign a unique identifier as the invoice number, such as a date. For example, an invoice received for services performed on January 7, 2004 could be assigned as invoice number 20040107. Following this procedure would flag any duplicates for further research.

The Authority did not ensure that contract obligations were sufficient to cover all invoice payments, as prescribed in Section II, page 4 of its Procurement Procedures Manual.

The Authority's contract register contained 9,179 transactions valued at \$244,772,453. The Authority paid invoices totaling \$817,898 for 32 transactions with a contract value of \$771,853. The Authority's payments exceeded the contract authority by \$46,045. Although the amount we identified is minimal, this condition should not occur since all expenditures should be covered by an obligation to protect the Authority from spending more than it has. The Authority's Director of Finance initially thought the automated system used by the Authority would not allow payments to be made if the invoice exceeded the contract amount. However, the Director said the problem occurred because of an improper system configuration when the Oracle-based Automated Data Processing System was initially set up.

The Authority's purchases are entered into its Oracle system either as a standard or blanket purchase. During our audit, the Authority's Director of Finance implemented corrective action for the standard purchases and was researching corrective action for blanket purchases.

Auditee Comments

[Excerpts paraphrased from the Housing Authority's comments on our draft finding follow. Appendix B, pages 4 to 6, 7 to 12, and 21 to 23 contain the complete text of the Authority's comments for this finding.]

Procurement under Federal law is very complex. The drafting of contract documents in order to eliminate ambiguity and to meet Federal guidelines is also very complex. Counsel approved the Authority's contracts as to content and form. The Authority reasonably believed that

its contracts were in good form because it had successfully avoided litigation arising out of a contract until March 2001 when Reco Security and Safety Consultants, Incorporated sued the Authority. The language in the 1996 and 1998 contracts with private security guard vendors created an ambiguity as to whether the hourly rate included sales tax. The alleged overpayment resulted from ambiguous contract language. To correct the ambiguity, the Authority revised its contract language to: a) more clearly provide for the payment of sales tax; and b) state that if there is a conflict between the contract and the proposal, the contract prevails.

In addition, the Authority addressed this issue in its supervisory training. Prior to June 2002 and the audit, the Authority was planning supervisory training for all supervisors who are also contract administrators. The supervisory training occurs almost on a monthly basis and covers a variety of topics including procurement. The supervisory training will be repeated each year for new supervisors and others as needed. In April 2003, the Authority's Procurement Department conducted a training session on procurement policy and procedures. In this training session, staff was instructed to read contracts and to know the terms of the contracts. Hopefully, this ongoing training and the revision in the contract language will help to reduce the ambiguity in contract administration.

The Authority believes that its limited and dwindling resources are best used to implement the changes that the Office of Inspector General has recommended and to continue to provide quality housing for low-income persons. The Authority respectfully requests that the recommendation that it reimburse the appropriate program from non-Federal funds in the amount of \$260,923 be deleted from the report because these payments are adequately documented and are eligible Federal costs.

OIG Evaluation Of Auditee Comments

In our review of the private security guard contracts, we found the contract language in the Requests for Proposals and in some of the final contracts to be ambiguous. It was for this reason that we only cited the two contracts with Reco Security and Safety Consultants, Incorporated, and the one contract with Avalon Security Corporation. For the 1996 contract, Reco Security was clear in their proposal that their hourly rate included sales tax. The Authority

accepted their proposal by awarding them the contract, and admitted that they erroneously paid \$55,356 in sales taxes to Reco Security. The Authority sought repayment of the overpaid sales taxes in its counterclaim to Reco's suit against them in 2003, but later dropped the claim in order to satisfy the outstanding sales tax obligation to the State of Minnesota.

In the 1998 contracts, the Authority was clearer in its contract language stating that it would compensate the contractor for services required, performed and accepted hereunder, inclusive of all costs and expenses, including Minnesota Sales Tax. However, it continued to erroneously pay sales taxes to Reco Security and Safety Consultants, Incorporated, and to Avalon Security Corporation, in the amounts of \$70,208 and \$135,359, respectively. The Authority realized its error in April 2000, and discontinued paying sales taxes as a separate line item on the invoices. The payments for sales taxes are ineligible costs.

Auditee Comments

The Authority segregated contract administrator's duties and increased the segregation of some functions. The reason for segregating contract administrator's duties is to guard against impropriety. It should be noted that the Office of Inspector General acknowledged that there is no evidence of fraud or other misconduct and there is no suggestion of fraud or impropriety in the report. The report states that the Authority did not properly segregate duties over its procurement process. The Authority agrees that the procurement process should provide for an adequate segregation of duties and claims that it has always had procedures in place to do so. The report states what contract administrators may do in the procurement process, but does not explain all of the steps in the Authority's procurement process. The report does not state the critical steps that provide control and accountability over the process.

Although a contract administrator may prepare the requisition form and determine the vendors to solicit, this form is merely a request to create a purchase order and is not provided to the vendor. The Contracting Officer reviews and approves the requisition form for compliance with procurement requirements, including but not limited

to the number and type of vendors to solicit. Only after the Contracting Officer approves the purchase order by signing it is the purchase order sent to the vendor.

Also, the contract administrator reviews invoices and certifies that the goods and/or services have been received before approving the invoice for payment. Contrary to what is stated in the report, payment is not authorized at this point. The accounting manager reviews the invoice for adequate documentation, the accounting staff records the transaction and the accounting manager approves the invoice for payment by check. Clearly, no one person has complete control over the procurement and payment process as alleged in the report.

Taking into consideration cost, time and the level of risk, the Authority will continue to evaluate the procurement process to increase segregation or introduce compensating controls as warranted. The Authority increased the segregation by requiring the signature of the solicitor and the solicitor's supervisor on the Request for Solicitation form.

OIG Evaluation Of Auditee Comments

Contract administrators were permitted to certify that goods and/or services were received, and to approve invoices for payment. These two functions are incompatible with good internal controls. The Authority states that the accounting manager approves the invoice for payment by check. As long as the accounting manager does not rely on the approval from the contract administrator, this would represent an acceptable segregation of duties, and meets the intent of our recommendation.

Auditee Comments

During the audit, the Authority agreed to improve procedures for paying by check. As the report indicates, the Authority revised its check request procedures in April 2003. The Authority has implemented and follows this procedure. As such, the check request procedure in the Authority's Procurement Procedures Manual, revised January 9, 2003, is outdated. The Authority believes that its current check request procedures comply with Federal regulation and should mitigate the risk of paying by check when a contract should be executed.

OIG Evaluation Of
Auditee Comments

We agree with the Authority's suggested actions for correcting our condition regarding the use of check requests when a contract should be executed.

Auditee Comments

The Authority has controls against duplicate payments. The contract administrator reviews and approves the invoice. It is reasonable to assume that the contract administrator will recognize duplicate invoices. Also, the financial software system will not allow an invoice to be entered if the same invoice number has already been entered for the vendor. In addition, if the invoice does not have a number, the Authority stamps a number on the invoice.

The duplicate payments in the amount of \$7,426 are eligible Federal costs. The Authority's policies and procedures give reasonable assurance of avoiding duplicate payments because in payments of over \$17 million, only \$7,426 resulted in over payments that represented 0.04 percent of the payments. These errors occurred because the contract administrator did not recognize the invoice as a duplicate and the invoice number was different. The supporting documentation showed the amount of overpayment, to whom payment was made and the basis for the overpayment. The Authority respectfully requests that the recommendation that it reimburse the appropriate program from non-Federal funds in the amount of \$7,426 be deleted from the Report.

Based upon the supporting documentation, the Authority will take steps to recover the overpayment from the police officers. Also, the Authority will perform a self-audit using a representative sample of payments. If the audit reveals that duplicate payments are occurring in a frequency or in an amount that warrants other controls, the Authority will implement the controls.

OIG Evaluation Of
Auditee Comments

Actions proposed by the Authority appear reasonable in determining if other duplicate payments have occurred. In the finding, we also suggest an alternative method for numbering invoices to more easily identify duplicates in the future. We also commend the Authority for taking the initiative to recover the overpayments. However, we disagree with the Authority's assessment that these duplicate payments represented eligible Federal costs.

They are ineligible because they were duplicate payments, and should be reimbursed into its Public Housing Program using non-Federal funds.

Auditee Comments

Since 1996, the Authority made payments of \$46,045 that exceeded the contract authority in 32 of 9,179 transactions valued at \$244,772,453. This represents less than 0.02 percent of the total funds contracted. To improve on this already very high percentage, the Authority has modified Oracle, its financial software, to hold a payment if it would exceed the contract authority until the authority is increased. This change should eliminate payments exceeding contract authority. In addition, the April 2003 procurement training informed contract administrators that purchases must be within available contract authority.

OIG Evaluation Of Auditee Comments

The Authority's actions adequately address the condition found during the audit where payments had exceeded the available contract authority. We agree that these amounts were immaterial to the total transactions incurred, but we identified this condition because the Oracle system should have precluded it from occurring at all.

Recommendations

We recommend that HUD's Director of Public Housing Hub, Minneapolis Field Office, assure the Minneapolis Public Housing Authority:

- 3A. Reimburses its Public Housing Program \$260,923 from non-Federal funds for the ineligible payment of sales taxes cited in this finding.
- 3B. Requests the reimbursement of \$7,426 in duplicate invoice payments from the appropriate vendor(s). If the Authority is unable to collect the duplicate payments from the vendor(s), then the Authority should reimburse its Public Housing Program \$7,426 from non-Federal funds.
- 3C. Segregates the duties of its employees so that no employee has complete control over all phases of any significant transaction.
- 3D. Implements adequate procedures and controls to ensure payments to contractors are made in

accordance with contract terms, and check requests are used in accordance with the Authority's Procurement Procedures Manual.

- 3E. Implements adequate procedures and controls to its contract authority system to prevent payments from exceeding contract amounts.

Management Controls

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are being met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Program Operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above during our audit of the Minneapolis Public Housing Authority's supplemental police services contracts.

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

Significant Weaknesses

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

- Program Operations.

The Authority did not properly administer its supplemental police services contracts according to Federal requirements and the Authority's Procurement Policies and Procedures. Specifically, the Authority did not: adequately execute or renew contracts on time; obtain Board approvals when required; ensure contract award recommendations were independently reviewed; ensure funds were obligated before incurring an expense; and ensure contractors were adequately monitored and their performance evaluated for compliance with contract terms (See Findings 1, 2, and 3).

- Compliance with Laws and Regulations

The Authority did not follow HUD's regulations and/or Office of Management and Budget Circular A-87 regarding the procurement of supplemental police services, preparation of independent cost estimates for evaluating quotes received, and proper administration of security contracts (See Findings 1 and 2).

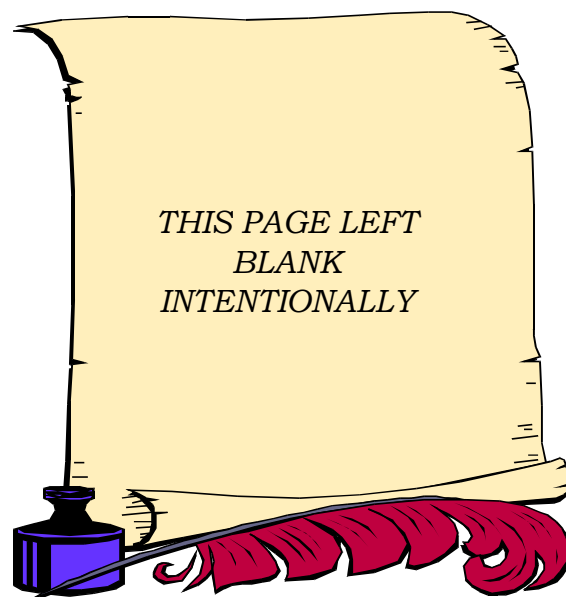
- Safeguarding Resources

The Authority failed to: (1) adequately support \$1,119,274 in payments to the off-duty police officers; and (2) implement an effective system of controls to prevent \$268,349 in misspent HUD funds consisting of \$260,923 in estimated overpaid Minnesota sales taxes and \$7,426 in duplicate invoice payments (See Findings 1 and 3).

Follow-Up On Prior Audits

This is the first audit of Minneapolis Public Housing Authority's Supplemental Police Services by HUD's Office of Inspector General. In 1993, we issued a report on the Authority's Comprehensive Improvement Assistance Program, report number 93-CH-201-1028, dated August 20, 1993. The report included issues related to noncompliance with procurement procedures for issuing professional service contracts, overpayments to contractors, internal control weaknesses, and improper spending of Comprehensive Improvement Assistance Program funds. The report contained three findings. Two of the findings were repeated in this report. The latest Independent Auditor's Report for the Authority (obtained during the audit) covered the period ending September 30, 2002. The report contained no findings.

Audit Report #93-CH-201-1028	This Report
Procurement of Professional Services Was Not According To Regulations (Finding 1)	The Administration of Supplemental Police Services Contracts Needed Improvement (Finding 2)
Contractors Were Overpaid \$28,300 (Finding 2)	Controls Over Contractor Payments Needed Improvement (Finding 3)

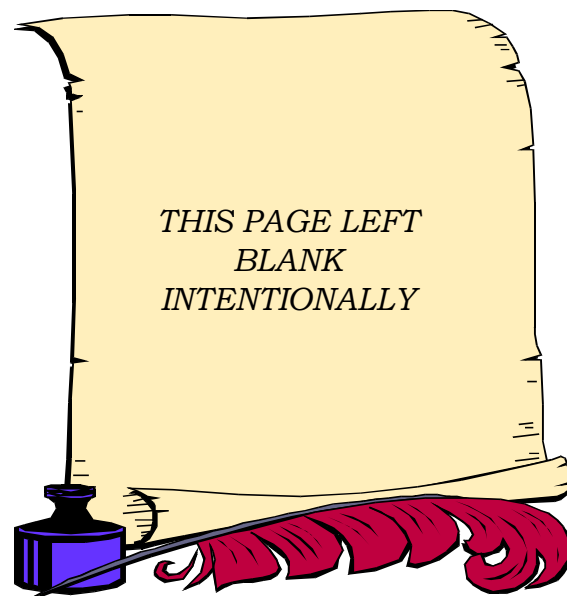


Schedule Of Questioned Costs

Recommendation Number	Type of Questioned Costs	
	Ineligible Costs <u>1/</u>	Unsupported Costs <u>2/</u>
1A		\$1,119,274
3A	\$260,923	
3B	<u>7,426</u>	
Totals	<u>\$268,349</u>	<u>\$1,119,274</u>

1/ Ineligible costs are costs charged to a HUD-financed or insured program or activity that the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations.

2/ Unsupported costs are costs charged to a HUD-financed or insured program or activity and eligibility cannot be determined at the time of the audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the cost. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.



Auditee Comments



January 29, 2004

TO: Thomas Towers, Assistant Regional Inspector General for Audit, 5FGA

FROM: Cora McCorvey, Executive Director of the Minneapolis Public Housing Authority

SUBJECT: Response to Office of Inspector General's Draft Audit Report Dated January 2004

From January to August 2003, the Office of Inspector General (OIG) dedicated one to three auditors from out of state to review supplemental police services procurement activities from 1996 to 2002 and 9,179 procurement transactions at the Minneapolis Public Housing Authority's (MPHA) administrative offices in Minneapolis, Minnesota. On December 29, 2003 the OIG sent the Draft Audit Report dated January 2004 to MPHA. The OIG asked MPHA to respond in 33 days or by January 31, 2004 to the Draft Audit Report.

MPHA had limited time and resources to respond to the Draft Report and has attempted to be thorough and complete. However, MPHA does not certify that if a specific fact or issue is not addressed, that MPHA agrees with the Draft Report. In some cases MPHA has agreed with the OIG's recommendations and has taken or will take action to improve procedures. Below MPHA has: a) requested revision to the Draft Report; b) stated the action it has taken or will take; and c) responded to the Executive Summary, Introduction, Finding 1, Finding 2 and Finding 3 from the Draft Report (Report).

MPHA expects that the OIG will consider this Response when preparing the final report. MPHA also requests an opportunity to respond in writing to the final report.

A. MPHA RESPECTFULLY REQUESTS THAT THE REPORT BE REVISED AS FOLLOWS:

1. To state that there is no evidence of fraud and that MPHA fully cooperated with the audit.

2. To state that MPHA relied upon a written proposal from Knight Security in administrating off-duty services and payments.
3. To state that the hourly rates paid pursuant to Knight Security's written Proposal were less than the rates MPHA had been paying to the Minneapolis Police Department (MPD) for the same service.
4. To state that payments in the amount of \$1,119,274 to off-duty police officers were adequately supported and are eligible federal costs.
5. Withdraw the recommendation that MPHA reimburse the appropriate program from non-federal funds in the amount of \$1,119,274 because these payments are adequately documented and are eligible federal costs.
6. To state that the private security guard vendor provided security guard services under several contracts and that there is no basis for alleging that MPHA suffered the alleged damages in the amount of \$168,687.
7. Withdraw the recommendation that the alleged damages in the amount of \$168,687 under several private security guard contracts are "funds to be put to better use."
8. To state that an ambiguity exists in three private security guard contracts as to whether MPHA overpaid sales tax in the amount of \$260,923 and that these payments are eligible federal costs.
9. Withdraw the recommendation that MPHA reimburse the appropriate program from non-federal funds in the amount of \$260,923 because these payments are adequately documented and are eligible federal costs.
10. To state that the overpayment in the amount of \$7,426 are eligible federal costs because MPHA's policies and procedures give reasonable assurance of avoiding duplicate payments as shown that in payments of over \$17 million, only \$7,426 resulted in duplicate payments which is 0.04%.
11. Withdraw the recommendation that MPHA reimburse the appropriate program from non-federal funds in the amount of \$7426. .
12. To state that 99.93% of the expenditures to Knight Security and to off-duty police officers were paid at the rate stated in Knight Security's written proposal.
13. Remove all references regarding the MPD rule that a police officer may not work more than 64 hours in week without the MPD's approval because the allegation that MPHA had a duty to enforce this rule is beyond the administration of the contract.
14. Remove all references to a poor contract administration system that the vendors did not perform and that MPHA suffered damages.

15. To state that MPHA's Executive Director properly exercised her responsibilities as shown by MPHA's constant evaluation and revision of policy and procedures before, during and after the audit and MPHA's designation as a high performer since 1997.

B. MPHA HAS TAKEN OR WILL TAKE THE FOLLOWING ACTION:

1. In 2002 MPHA began planning to reorganize and centralize the Procurement Department.
2. As of January 2004 the duties of the Director of Procurement are dedicated solely to the Procurement Department.
3. On April 16, 2003 MPHA revised its check request procedure.
4. Prior to June 2002, MPHA began planning a mandatory Supervisory Training to provide almost monthly sessions on a variety of topics to all supervisors. The Supervisory Training will be repeated each year for new supervisors and others as appropriate. In April 2003 the Procurement Department presented a session on procurement policy and procedure.
5. By April 2004 MPHA plans to have procedures in place so that recommendations for awards of procurement contracts are reviewed by the Contracting Officer before going to the Board of Commissioners for approval.
6. MPHA will revise the Board Report form for an award of a procurement contract to show that the Contracting Officer has reviewed and is recommending the award of the contract.
7. MPHA has modified procurement procedures so that costs estimates are required prior to the solicitation of vendors.
8. In January 2004 MPHA increased the segregation of the contract administrator's duties by revising the Purchase Requisition Form and Request for Solicitation form to require the signature of the solicitor and the solicitor's supervisor.
9. MPHA will examine other steps in the procurement to payment process to further segregate duties as is reasonable and warranted.
10. MPHA is creating an internal audit function. This function may informally audit MPHA's policies and procedures in a variety of areas including procurement.
11. MPHA has modified Oracle, its finance software, so that the end user cannot override the system to allow payments in excess of the contract authority.
12. MPHA will take action to recover the duplicate payments to the off-duty officers.

13. MPHA has improved procedures to meet deadlines for extending contract dates or limits of authority or to re-solicit. The Procurement Department provides a monthly report to the Deputy Executive Director on the upcoming deadlines. The goal is to have new contracts in place by the time the old contract expires and to reduce the use of purchase orders between contracts.
14. To reduce the ambiguity in contract language, MPHA modified contract language to more clearly state the pricing or hourly rates and to clarify that if there is a conflict between the contract, the RFP or the vendor's proposal that the contract language controls.
15. MPHA will perform occasional self-audits in the payment process.
16. MPHA will revise the Procurement Policy to state that Board approval is not needed for: a) a change order increasing the first year of the contract up to 25%; b) extending the contract for a second year if the Board's initial authorization permitted MPHA to renew a contract for a second year; and c) a change order to increase the second year of the contract up to 25% without Board approval.
17. MPHA is a high performer and as in every aspect of its operations, will continue to evaluate and improve procurement policies and procedures.

C. MPHA'S RESPONSE TO THE EXECUTIVE SUMMARY

MPHA assumes that the phrase "supplemental police services" includes private security guards services, police services contracted directly between MPHA and the Minneapolis Police Department (MPD) and services for off duty police officers.

1. Payments to off-duty police officers are adequately supported and are eligible federal costs.

MPHA agrees that it is good business practice and HUD and MPHA's policy to execute written contracts for services such as Knight Security and off-duty police officers. MPHA agrees that it should have had a formal written contract with Board approval for the off-duty police services and will do so in the future. MPHA also notes that it has not contracted with Knight Security since December 2000.

The Report does not mention that MPHA relied upon a written Proposal submitted by Knight Security. The Proposal clearly states the hourly rates for regular and holiday hours worked. These rates were less than the hourly rates that MPHA had been paying the MPD for off-duty services. Technically speaking MPHA should have had a written contract, but practically speaking, MPHA had a written basis for its actions and payments.

MPHA strongly disagrees with the assertion that off-duty police officer payments lacked adequate support and are not allowable federal costs. For the reasons stated below it is clear that the payments had adequate support.

As the Report states, OMB Circular A-87 "Cost Principles for State, Local and Indian Tribal Governments," Attachment A, paragraph C (1) lists the "factors affecting allowability of costs." To be allowable, "costs must meet the following general criteria." One of the general criteria is C (1) (j) which states that the costs are to "be adequately documented." The phrase "adequately supported" is not used in paragraph C.

However 24 C.F.R. 24.105 defines the term "adequate evidence" for purposes of debarment or suspension of certain grants. The term means "[i]nformation sufficient to support the reasonable belief that a particular act or omission has occurred." There is ample evidence to support the reasonable belief that the officers performed the off-duty police services for MPHA. These documents include weekly invoices, deposition testimony of Sgt. Art Knight and affidavits of several property managers that the officers performed the work, Sgt. Knight's written Proposal, memorandum from Lt. Don Harris that the off duty police service was effective in reducing crime and unauthorized entries (Exhibit A) and the signatures of MPHA's Deputy Executive Director and Accounting Manager authorizing payment.

Also 24 C.F.R. §85.20 (b) (6) states that accounting records are to "be supported by such source documentation as. . ." The phrase "such as" is not defined by the CFR, but case law indicates that "such as" means like or similar to the classifications named. See *Board of Adjustments of City of San Antonio v. Levinson*, 244 S.W. 2d 281, 282-83 (Tex. Civ. App. 1951); *Erwin v. Steele*, 228 S.W.2d 882, 885 (Tex. Civ. App. 1950); and *Charles Behlen Sons' Co. v. Ricketts*, 164 N.E. 436, 176 (Ohio Ct. App. 1828).

The examples listed in the CFR include "cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc." The examples are not mandatory or exhaustive. Nowhere in the list does the term "summary timesheet" appear. Yet the Report concludes that "summary timesheets" were mandatory "to substantiate the amounts claimed or hours worked." This conclusion is unsupported by the CFR or the OMB. Also, there is no evidence under any authoritative accounting standards that weekly invoices which identify the name of the officer, the payment amount, the services rendered and number of hours worked by week is insufficient.

MPHA produced cancelled checks and paid bills, items which are clearly listed in the CFR as "adequate documentation." The paid bills were made up of weekly invoices showing the number of hours worked each week by each officer. These invoices were similar to a weekly timesheet. The weekly invoices, the list of the seven buildings which had off-duty police service and Knight Security's written Proposal identify who performed the work, what services were rendered, when the services were rendered, where the services were rendered and why MPHA needed the services.

In addition the Report provides evidence that this documentation was adequate. The Report states that duplicate payments were made, that various hourly rates were paid and that one officer worked more than 11 hours per day. It is contradictory to draw these conclusions from the payment documentation and then state that the payments lacked adequate documentation. Taken as a whole, there is substantial evidence to show

adequate support and a reasonable belief that the officers performed the off-duty police services for MPHA.

MPHA respectfully requests that the OIG revise its Report to delete the recommendation that MPHA should reimburse the appropriate Program from non-federal funds in the applicable amount. This request is based upon:

- a) the admitted need and success of the off-duty police service;
- b) the fact that in 99.93% of the time, MPHA paid the officers a regular hourly rate of \$23 or a holiday hourly rate of \$33;
- c) the clear language in 24 C.F.R. 85.20 (b) (6) which is misquoted in the Report;
- d) the payment documentation provided to support the police services;
- e) MPHA's acknowledged cooperation throughout the entire audit process;
- f) MPHA's willingness to change procedures, some of which were immediate or in place prior to the audit;
- g) MPHA's reorganization of the Procurement Department;
- h) MPHA's commitment to train staff as shown by the supervisory training which was being planned prior the audit;
- i) the fact that MPHA has not used Knight Security since December 2000;
- j) MPHA's success in maintaining quality low income housing as shown by its high performer status and positive resident reviews; and
- k) the lack of any evidence of fraud or misconduct.

MPHA believes that its limited and dwindling resources are best used to implement the changes that the OIG has recommended and to continue to provide quality housing for low-income persons. MPHA respectfully requests that the recommendation that MPHA reimburse the appropriated program from non-federal funds in the amount of \$1,119,274 be deleted from the Report because these payments are adequately documented and are eligible federal costs.

2. Reco provided security guard services and there is no basis for alleging that MPHA suffered the alleged damages in the amount of \$168,687.

MPHA disputes that it inadequately documented contractor performance resulting in a loss of \$168,687 in alleged damages. MPHA pled these alleged damages as a counterclaim in a lawsuit brought by Reco Security Safety and Safety Consultants (Reco). In 2001 Reco sued MPHA alleging 15 counts based upon breach of contract, unjust enrichment, injunctive relief, declaratory relief, conversion, racial discrimination and retaliation under 42 U.S.C. §1981, and violation of 42 U.S.C. §1983, the Minnesota Human Rights Act, Minn. Stat. § 471.345 (competitive bidding law), common law competitive bidding laws and Minn. Stat. § 326.3381 (licenses for protective agents) arising out of a 1996 and 1998 contract between the parties for security guard services, a 2001 public bidding process for security services and a contract for off-duty police services between MPHA and Knight Security.

Reco claimed over \$1,198,508 in damages and an undetermined amount of damages for violating §1983. As part of a litigation strategy and in an effort to discredit Reco's claims and to ultimately save scarce public resources, MPHA counterclaimed for breach of the 1996, 1998 and 2000 contracts between the parties. It is incomprehensible that a litigation strategy which the trial court dismissed by summary judgment would form the basis for an audit finding.

In the Summary Judgment Order dated June 17, 2003 (Exhibit B), which is the law of the case, the Hennepin County District Court dismissed two of Reco's counts and all of MPHA's counterclaims. The Court acknowledged that MPHA was seeking damages in the amount of \$168,687 and that MPHA estimated the damages at \$1.00 per hour of guard services provided by Reco, 168,687. (Exhibit B at p. 22 & 24). The Court dismissed the counterclaims stating "no basis whatsoever is provided for [the] calculation of damages at '\$1.00 per guard hour.' The figure was apparently picked at random and bears no relation to any bona fide measure of damages." (Exhibit B at p. 24). The Court also stated that Reco guards were on duty for assigned shifts and did provide security services. *Id.* The Court went on to state that MPHA's alleged damages were wholly conjectural and unfounded and dismissed the counterclaims in their entirety.

Similarly, the statement in the Report that MPHA "inadequately documented contractor performance resulting in the loss of \$168,687 in alleged damages" has no basis and is conjectural and unfounded. As the Court stated, even if Reco had breached the contract, MPHA had no damages because Reco provided security guard services for the assigned shifts.

The Report also ignores the fact that MPHA did not pay any damages to Reco and obtained a defense verdict at trial. Now apparently under the guise of auditing principles, the Report assumes with no evidence that Reco did not perform and that MPHA suffered damages. The Report ignores the legal finding that MPHA simply had no damages because the security guard service was provided.

MPHA believes that its limited and dwindling resources are best used to implement the changes that the OIG has recommended and to continue to provide quality housing for low-income persons. MPHA respectfully requests that the recommendation that the alleged damages in the amount of \$168,687 under several private security guard contracts are "funds to be put to better use" be deleted from the Report because the vendors provided the service and MPHA does not have any damages.

3. An ambiguity exists in the three private security guard contracts as to whether MPHA overpaid sales tax in the amount of \$260,923 and these payments are eligible federal costs.

Procurement under federal law is very complex. The drafting of contract documents in order to eliminate ambiguity and to meet federal guidelines is also very complex. MPHA's contracts have always been approved by counsel as to content and form. MPHA reasonably believed that its contracts were in good form because MPHA had

successfully avoided litigation arising out of a contract until March 2001 when Reco sued MPHA. For the reasons stated below the language in the 1996 and 1998 contracts with private security guard vendors created an ambiguity as to whether the hourly rate included sales tax.

The Report states that MPHA improperly paid sales tax in the amount of \$55,356 under the 1996 Reco Contract and \$70,208 under the 1998 Reco Contract and \$135,359 under Contract 97.74A with Avalon Security Corporation (Avalon). For purposes of this Report MPHA agrees with the calculations of the sales tax but disagrees that the sales tax was paid improperly.

The Report correctly states that MPHA believed that it paid sales tax under a mistake of fact. But the Report fails to state that MPHA brought a summary judgment motion in the Reco lawsuit on this issue and that the Court denied summary judgment because of ambiguity in the contract documents.

In April 2000, MPHA sent a letter to Reco and Avalon stating that it would no longer pay sales tax as a separate line item. Reco disagreed and in part sued MPHA for the unpaid sales tax under the 1998 contract. The Court in the Summary Judgment Order stated Reco believed that the Contracts and the Requests for Proposal (RFP) and its Responses to the RFPs which were exhibits to the Contract showed that sales tax was a separate line item. (Exhibit B at p.10). In addition, Reco billed for sales tax from the beginning showing that Reco believed that sales tax was a separate line item. (Exhibit B at p.10). As a result the Court ruled that an ambiguity in the contract language existed as to whether sales tax was a separate line item.

At oral argument on the Summary Judgment Motion, the Court stated it was going to dismiss all outstanding claims except for Reco's claims under the 1996 Contract and MPHA's claim for sales tax under the 1996 and 1998 Contracts. Prior to the issuance of the Summary Judgment Order, MPHA decided that it could lose on the sales tax claim and that under the 1998 Contract could pay significant attorneys fees for taking the claim to trial.

Furthermore, under Minn. Stat. § 297A et. al. Reco and MPHA have the duty to make sure that the sales tax is paid to the Minnesota Department of Revenue. Clearly, fact issues exist as to whether sales tax was a separate line item under the contracts.

MPHA decided that it was more prudent and cost effective use of federal funds to resolve the issue and pay the remaining sales tax of \$7,728.96 under the 1998 Contract to the Minnesota Department of Revenue. In doing so, Reco's only claim, the breach of the 1996 Contract, was decided by a jury. Reco claimed over \$280,000 in damages for breach of the 1996 Contract. The jury returned a defense verdict and MPHA was awarded \$9,324 in costs and disbursements.

Also, there is no doubt that there is an ambiguity as to whether MPHA was obligated to pay sales tax as a separate line item under the Avalon Contract. The Avalon Contract is

very similar to the Reco Contract on this issue. In addition, Avalon's Proposal to the RFP, which is a Contract exhibit, specifically states that its hourly rate "does not include the 6.5% Minnesota Sales Tax."

Also, the Report provides that one contractor (assumed to be Avalon under Contract 96.38) "stated in its proposal that its hourly rate did not include sales tax." The Report further stated that the sales tax was paid under this Contract but that this was not an error because MPHA accepted the proposal.

The Report concludes that MPHA did not err in paying sales tax under the 96.38 Contract with Avalon but fails to acknowledge that Avalon's Proposals to the 96.38 and 97.74A Contracts contained the same language; that the hourly rate "does not include the Minnesota Sales Tax." In each Contract, the Proposal was an exhibit to and incorporated in the Contract. Yet, the Report concludes in one Contract that sales tax should have been paid and in the other concludes payment as an error.

The Report also concludes that the payment of the sales tax could have been avoided if MPHA had reviewed the terms of the Contracts before approving invoices. This conclusion is erroneous. The confusion arose from the inherent ambiguity in the Contract documents. It is total speculation to conclude that an earlier resolution would have avoided the payment of sales tax; particularly because the Avalon Proposal stated that sales tax was not included in the hourly rate. Also, Reco's Proposal was significantly lower. Without the payment of sales tax, Reco may have been unable to perform, in which case MPHA would have contracted with another vendor at a higher hourly rate in excess of 6.5%.

The alleged overpayment resulted from ambiguous contract language. To correct the ambiguity, MPHA revised its contract language to: a) more clearly provide for the payment of sales tax; and b) state that if there is a conflict between the contract and the proposal, that the contract prevails.

In addition, MPHA addressed this issue in its Supervisory Training. Prior to June 2002 and the audit, MPHA was planning a Supervisory Training for all supervisors who are also contract administrators. The Supervisory Training occurs almost on a monthly basis and covers a variety of topics including procurement. The Supervisory Training will be repeated each year for new supervisors and others as needed.

In April 2003 MPHA's Procurement Department conducted a training session on procurement policy and procedures. In this training session, staff was instructed to read contracts and to know the terms of the contract. Hopefully, this ongoing training and the revision in the contract language will help to reduce the ambiguity in contract administration.

MPHA believes that its limited and dwindling resources are best used to implement the changes that the OIG has recommended and to continue to provide quality housing for low-income persons. MPHA respectfully requests that the recommendation that MPHA

reimburse the appropriated program from non-federal funds in the amount of \$260,923 be deleted from the Report because these payments are adequately documented and are eligible federal costs.

4. MPHA estimates that by April 2004, it will have procedures in place so that procurement contract awards are reviewed by the Contracting Officer before going to the Board of Commissioners for approval.

MPHA is in the process of reorganizing its Procurement Department. The goal is to centralize procurement so that a select number of persons become very familiar with policy and procedures and are more easily supervised. This reorganization should also foster ongoing improvement in procurement policy and procedures.

MPHA will amend its Procurement Procedure Manual to require review of procurement contract awards by the Contracting Officer or designee prior to the submission to the Board for approval. In addition, MPHA will revise the Board Report form for an award of a procurement contract to show that the Contracting Officer has reviewed and is recommending the award of contract. MPHA estimates that these changes will occur by April 2004.

5. Federal requirements allow discretion on the method and degree of analysis in performing a cost or price analysis.

24 C.F.R. 85.36 (f) states a grantee must perform a cost or price analysis and that “[t]he method and degree of analysis is dependent on the facts surrounding the particular procurement situation.” Furthermore, “price reasonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulation.” Federal requirement allows for discretion in the “method and degree of analysis.” This discretion is in recognition that substance is more important than form.

Practically speaking, MPHA performed a cost or price analysis for supplemental police services by receiving bids every two years beginning in 1993 in a formal bid process for private security guard services. In addition, the cost of police officers and off-duty police services are a sole source and are dependent upon the established hourly rates of the officers. Based upon this information and taking inflation into consideration, MPHA had the basis for a cost or price analysis.

In response to the Report, MPHA has modified its Request for Solicitation form to formally document the cost estimate for goods and services prior to the solicitation of a formal contract. Also, MPHA will continue to evaluate its processes and forms for informal procurement.

6. MPHA has and will continue to change procedures to improve the disbursement of funds in accordance with proscribed procedures.

Prior to the audit, MPHA was planning a comprehensive supervisory training to provide monthly classes on a variety of topics. The April 2003 class involved training on procurement and payment. MPHA intends to repeat the training each year for new supervisors and other supervisors as necessary.

MPHA is also creating an internal audit function. This function may informally audit MPHA's policies and procedures in a variety of areas including procurement and thereby improve MPHA's adherence to policy and procedure.

It is also anticipated that a centralized Procurement Department will issue periodic reminders to staff on how to comply with procurement procedures and will more effectively assist staff to comply.

7. MPHA has adequate segregations of contract administrator's duties but has increased the segregation of some functions.

The reason for segregating contract administrator's duties is to guard against impropriety. It should be noted that the OIG acknowledged that there is no evidence of fraud or other misconduct and there is no suggestion of fraud or impropriety in the Report. The Report states that MPHA did not properly segregate duties over its procurement process. MPHA agrees that the procurement process should provide for an adequate segregation of duties and claims that it has always had procedures in place to do so. The Report states what contract administrators may do in the procurement process, but does not explain all of the steps in MPHA's procurement process. The Report does not state the critical steps which provide control and accountability over the process.

Although a contract administrator may prepare the requisition form and determine the vendors to solicit, this form is merely a request to create a purchase order and is not provided to the vendor. The Contracting Officer reviews and approves the requisition form for compliance with procurement requirements, including but not limited to the number and type of vendors to solicit. Only after the Contracting Officer approves the purchase order by signing it, is the purchase order sent to the vendor.

Also, the contract administrator reviews invoices and certifies that the goods and/or services have been received before approving the invoice for payment. Contrary to what is stated in the Report, payment is NOT authorized at this point. The accounting manager reviews the invoice for adequate documentation, the accounting staff records the transaction and the accounting manager approves the invoice for payment by check. Clearly, no one person has complete control over the procurement and payment process as alleged in the Report.

Taking into consideration cost, time and the level of risk MPHA will continue to evaluate the procurement process to increase segregation or introduce compensating controls as warranted. MPHA has increased the segregation by requiring the signature of the solicitor and the solicitor's supervisor on the Request for Solicitation form.

8. MPHA revised procedures for check requests in April 2003.

During the audit MPHA agreed to improve procedures for paying by check. As the Report indicates, MPHA revised its check request procedures in April 2003. MPHA has implemented and follows this procedure. As such, the check request procedure in MPHA's Procurement Procedures Manual, revised January 9, 2003, is outdated. MPHA believes that its current check request procedures comply with federal regulation and should mitigate the risk of paying by check when a contract should be executed.

9. MPHA has procedures to reserve and obligate funds prior to expenditure and retrained staff in April 2003 to improve compliance with the procedures.

MPHA has had procedures in place to obligate funds prior to expenditure. But MPHA agrees that on occasion expenses were incurred before funds were obligated and reserved. The April 2003 procurement training informed contract administrators that purchases must be within available contract authority. MPHA is evaluating software and other tools to assist contract administrators in keeping track of the contract balance.

Also, the reorganization of the Procurement Department will foster compliance with this requirement. As a result of the reorganization, MPHA has instituted a procedure whereby the Procurement Department provides a monthly report to the Deputy Executive Director on the upcoming deadlines to extend contract dates or limits of authority or to re-solicit. MPHA's goal is to have new contracts in place by the time the old contract expires and to reduce the use of purchase orders between contracts.

D. MPHA'S RESPONSE TO THE INTRODUCTION

1. The Report does not indicate that the following documents were reviewed and considered:

- a. Memorandum from Lt. Don Harris stating that the off-duty police service was effective. (Exhibit A);
- b. Summary Judgment Order dated June 17, 2003 from the Hennepin County District Court in the case of *Reco Security & Safety Consultants v. MPHA*. (Exhibit B);
- c. Affidavits of several MPHA Property Managers stating that the MPD police officers performed off-duty police services. (Exhibit C); and
- d. Knight Security's written Proposal which is an exhibit to his deposition.

2. MPHA offers the facts for consideration:

- a. MPHA stopped using Knight Security in December 2000.

- b. From August 1997 to the present, MPHA has consistently had a written contract with the City of Minneapolis for police services except for the year of 2001.
- c. For the reasons stated in MPHA's Response to the Report's Executive Summary (C 3), MPHA did not overpay sales tax.
- d. Upon information and belief, Sgt. Knight's deposition and Affidavit of the former Deputy Executive Director were provided by MPHA's Director of Legal Services and not "complainant's legal counsel."

E. MPHA'S RESPONSE TO FINDING 1

1. 24 C.F.R. 85.20 (b) (6) is misquoted in the Report.

24 C.F.R. 85.20 (b) (6) does not "require time and attendance records." This section states that "[a]ccounting records must be supported by *such* source documentation as cancelled checks, paid bills, payrolls, time and attendance records and subgrant award documents, etc." (emphasis added). As stated above in MPHA's Response to the Executive Summary, (C 1) "such as" means like or similar to the classifications named. MPHA had cancelled checks, paid bills, invoices and a written proposal. The CFR specifically lists cancelled checks and paid bills as examples of source documentation. In addition, from these documents the hourly rate, the name and social security number of the officer and the hours worked per week can be determined. These documents are in all respects similar to time and attendance records.

2. Information is available to determine the funding source for \$28,386 in HUD funds.

The Report states that MPHA is unable to document the funding source for \$28,386 in HUD funds. First, there is no doubt that the funding source is either capital funds, operating subsidy or Public Housing Drug Elimination Program (PHDEP) funds. Secondly, MPHA has the documents to identify the funding source but would need additional time and resources to do. However, MPHA fails to see the relevance in producing this information at this time. These funds were reported on MPHA's financial statements and HUD's Financial Data Schedule and have already been audited for compliance.

3. Off-duty police officers provided services at six projects and seven buildings because one project has two buildings.

4. MPHA's contract with Knight Security was based upon a written proposal, weekly invoices, check requests and the course of dealing between the parties.

While MPHA did not have a formal written contract with Knight Security, the contract was based upon Knight's written proposal, the weekly invoices, check requests and the

course of dealing between the parties. See MPHA's Response to Executive Summary (C 1).

5. The Report misquotes the Director of Legal Services.

MPHA's Deputy Executive Director and not the Director of Legal Services stated that a written contract with Knight Security was not necessary because of the existing contract between MPHA and the MPD and the Cooperation Agreement between MPHA and the City of Minneapolis.

6. The Report misquotes the Director of Finance.

MPHA's former Director of Finance and former Deputy Executive Director approved the use of checks to pay off-duty officers in 1999 and 2000. As such the current Director of Finance assumed this practice was permitted and did not claim that the practice was an oversight. As noted in the Report, MPHA corrected this matter over a year ago in March 2003.

7. 99.93% of the expenditures to Knight Security and the off-duty police officers were paid at the rate stated in Knight Security's written Proposal.

The lack of a formal written contract and the use of check requests did not result in a lack of adequate controls over the rates charged for the off-duty police officers as suggested in the Report. MPHA agrees that it should have had a formal written contract and should have not used check requests to pay for off duty police services. However, Knight Security's written Proposal clearly states that regular hourly rate is \$23 per hour and the holiday rate is \$33 per hour.

Out of the 5,427 invoices audited, MPHA has reviewed the 141 invoices cited in the Report as support for the allegation that the hourly rate for the police officers varied between \$23 and \$33. The review is documented in "Details of Off-Duty Police Officers Hourly Rates of \$23 and \$33." (Exhibit D).

First, Exhibit D shows that in three invoices that the number of hours stated in the Report does not reflect the number of hours in the invoice. The hourly rate in these three invoices is \$23 when based upon the correct number of hours in the invoices. The alleged variance in the hourly rate is due to an error in the Report.

Second, 125 invoices reflect services provided in a week where a holiday occurred. Because the invoice shows the numbers of hours worked, it is mathematically possible to determine which hours were paid at the regular rate of \$23 and the holiday rate of \$33. In all of the 125 invoices, the hourly rate was either \$23 or \$33 per hour. Exhibit D shows the number of hours worked at \$23 per hour and \$33 per hour. These payments were not in error, the hourly rate was not haphazardly applied and the rates paid were consistent with Knight's written Proposal.

Third, in 13 invoices the hourly rate varies from \$23 or \$33 per hour. These 13 invoices result in a total overpayment of \$774. Out of the \$1,251,783 paid to Knight Security and the police officers, less than 0.07% of the expenditures deviated from the \$23 or \$33 hourly rate. In other words, 99.93% of the expenditures were paid at the proposed rates of \$23 or \$33 per hour. MPHA strives for perfection, but recognizes that people may make mistakes and all entities face the risk of an occasional error.

Fourth, it has always been MPHA's practice to incorporate a proposal or response as an exhibit to the contract. See the cover page to the various private security guard contracts incorporating the proposal as an exhibit. Also, beginning in 1998, the Section titled "Compensation" in the security guard contract, referred to the "fee schedule" in the proposal.

A formal written contract with Knight Security would have incorporated Knight Security's Proposal as an exhibit to the contract and would have referred to the fee schedule in the Proposal. As such a written contract would have made no difference as regards the understanding of the hourly rate.

Prior to this Audit, MPHA revised the contract language so that the hourly rate is specifically stated in the contract and that if there is any discrepancy between the contract and the proposal, the contract controls. However, these changes did not occur until after MPHA stopped using Knight Security in December 2000.

In conclusion, MPHA properly administered payment according to the proposed fee schedule. In the 141 invoices where it appeared that the hourly rate exceeded \$23 per hour, it occurred in weeks with a holiday. Except for the sum of \$774, all of the alleged discrepancies in the hourly rate are explained by the holiday rate of \$33 per hour.

Also, the variances in the hourly rate based upon hourly rates of \$23 and \$33 resulted in a total overpayment of \$774 which is less than 0.07 % of the total expenditure for off-duty police services. The payments were accurate up to 99.93% of the time.

In addition there is no evidence that a formal written contract which would have incorporated the fee schedule in the proposal would have made any difference in payment.

8. MPHA's enforcement of MPD's 64 hour work week rule is beyond the scope of contract administration and is not an accounting function.

MPHA respectfully disagrees that it was required to enforce the rule established by the MPD that an officer may not work more than 64 hours in a week without approval. First, this rule is an MPD rule. MPHA had no duty to enforce this rule or any other MPD rule.

Second, the MPD was never a party to the contract for off-duty officers. The contract was between Knight Security and MPHA and MPHA directly paid the officers.

Third, it is possible that the three officers who allegedly worked in excess of 64 hours may have been on vacation with the MPD.

Fourth, at best the Report indicates that only three officers out of 146 exceeded the 64 hour rule. It is not cost effective or an efficient use of MPHA staff time to monitor 146 officers to perhaps determine that three officers violated an MPD rule.

Fifth, under contract law, even if an officer violated the rule, MPHA was obligated to pay the officer for the work performed.

Sixth, MPHA treated the police officers as independent contractors and not employees. In doing so, MPHA was not responsible for providing worker's compensation or other employee benefits. In exchange MPHA did not have the right to control the means and manner of performance or the number of hours that a police officer worked. It is well established in Minnesota that in determining whether a person is an employee or independent contractor the most important factor "is the right of the employer to control the means and manner of performance." *Farnam v. Linden Hills Congregational Church*, 149 N.W.2d 689, 695 (Minn. 1967). It is inconceivable that MPHA would risk jeopardizing the officer's status as an independent contractor by attempting to enforce any MPD rule, including the 64 hour rule.

Lastly, MPHA does not limit the numbers of hours that other independent contractors may work and has no legal basis for treating police officers differently. For the reasons stated above, MPHA had no duty to enforce the MPD's 64 hour work rule.

9. In April 2003, MPHA revised check request procedures. See MPHA's Response to Executive Summary (C 8).

10. MPHA has complied with the recommendation to execute professional contracts for services in excess of \$25,000.

MPHA's Procurement Policy and Procedures require a written contract for professional services in excess of \$25,000. This is an internal policy established by MPHA and is not required by state or federal law. On occasion MPHA has obtained professional services in excess of \$25,000 by purchase order between formal written contracts and for sole source police services.

In the future, MPHA's Procurement Department will more closely monitor the procurement of professional services to require a written contract. Also, by April 2004, MPHA intends to have procedures in place so that contract awards are reviewed by the Contracting Officer before going to the Board of Commissioners for approval. See MPHA's Response to the Executive Summary (C 1 and C 4).

11. Payments to off-duty police officers are adequately supported and are eligible federal costs.

MPHA respectfully requests that the OIG revise its Report to delete the recommendation that MPHA should reimburse the appropriate Program from non-federal funds in the applicable amount. This request is based upon:

- a) the admitted need and success of the off-duty police service;
- b) the fact that in 99.93% of the time, MPHA paid the officers an hourly rate of \$23 or \$33;
- c) the clear language in 24 C.F.R. 85.20 (b) (6) which is misquoted in the Report;
- d) the payment documentation provided to support the police services;
- e) MPHA's acknowledged cooperation throughout the entire audit process;
- f) MPHA's willingness to change procedures, which in some cases were immediate or were in place prior to the audit;
- g) MPHA's reorganization of the Procurement Department;
- h) MPHA's commitment to train staff as evidenced by the supervisory training which was being planned prior the audit;
- i) the fact that MPHA has not used Knight Security since December 2000;
- j) MPHA's success in maintaining quality low income housing as shown by its high performer status and positive resident reviews; and
- k) the lack of any evidence of fraud or misconduct.

MPHA believes that its limited and dwindling resources are best used to implement the changes that the OIG has recommended and to continue to provide quality housing for low income persons. MPHA respectfully requests that the recommendation that MPHA reimburse the appropriate program from non-federal funds in the amount of \$1,119,274 be deleted from the Report because these payments are adequately documented and are eligible federal costs. See MPHA's Response to Executive Summary (C 1).

F. MPHA's RESPONSE TO FINDING 2

1. Federal requirements allow discretion on the method and degree of analysis in performing a cost or price analysis.

The Report states that MPHA did not have supporting documentation on how the projected hours for private security guard vendors were estimated or how the corresponding dollar amounts were determined. MPHA estimated the number of hours based upon the hours incurred at the time of the RFP plus some additional hours to allow for discretion in increasing the number of hours. The estimated number of hours was then multiplied by the hourly rate. See MPHA's Response to Executive Summary (C 5).

2. MPHA has taken and will take action to timely execute and renew contracts.

For the reasons stated below, MPHA denies that the delays in signing and renewing contracts were due to the Legal Department or lack of urgency on the part of the Procurement Department. Also, MPHA does not have a Director of Resident Services and clarifies that the Director of Resident Initiatives did not state that contracting is tedious and may have said "extensive." For the reasons stated below, MPHA timely executes and renews most contracts.

First, contracting with the City of Minneapolis for police services is a very extensive process which includes approval from the City of Minneapolis' Mayor, Chief of Police, City Council, Attorney and City Clerk. Clearly, MPHA does not have control over the process and has to contract with the City because police services are a sole source. Even with the complicated process, MPHA timely executed and renewed contracts with the MPD in six out of seven years or from 1997 through 2003 (excluding the year of 2001).

Second, MPHA timely executed contracts with private security guard vendors except for several months in 2000. In 2000 between contracts with Reco, MPHA used purchase orders for less than two months from May 8, 2000 to July 3, 2000. During this period MPHA paid rates under the 1998 contract and actually saved money. The main reason for the delay was because Reco wanted a higher hourly rate than the rate presented in its Proposal. On June 22, 2000, MPHA sent a letter to Reco, stating that if Reco did not sign the contract with the rate stated in its Proposal, MPHA would select another vendor. See Exhibit E. MPHA signed a contract with Reco effective July 3, 2000.

MPHA also used a purchase order with Avalon from May 8, 2000 until June 12, 2000 when MPHA signed a contract with a new vendor, Burns International Security Service Corp. (Burns). Extra time was needed to negotiate the final contract with the new vendor.

Third, Burns had a 2000 contract when MPHA advertised an RFP in 2001. In June 2001 the Board approved the award of a contract to Burns as the sole vendor for all private security guard services. In the past, MPHA had separate vendors for north high-rise and south high-rise. When the Board approved the award in June 2001, Burns was already under contract with MPHA at a lower hourly rate than the rate in its 2001 Proposal. As such, MPHA extended the 2000 contract with Burns at the lower hourly rate before executing the new contract, PH-1.42, in February 2002.

Fourth, MPHA agrees that it should have a signed contract with Knight Security. However, MPHA has not used Knight Security in over three years or since December 2000.

Fifth, MPHA agrees that some less needed services may be temporarily halted until a written contract is signed. But supplemental police services are extremely important and should not be temporarily halted. It is poor management and a narrow-sighted interpretation of federal regulation to require every PHA in every instance to discontinue

a service because a written contract is not in place. MPHA has improved its procurement procedures and respectfully requests the option to use purchase orders in some cases.

Sixth, the Report states that Attachment A is part of MPHA's Procurement Procedures and requires Board approval for the renewal of a contract for a second year when MPHA executes a change order in excess of 25% in the first year and when the Board's initial authorization permits MPHA to renew a contract for a second year. As explained below, this interpretation is unreasonable.

Attachment A is dated April 24, 2002, and is an exhibit to MPHA's Procurement Policy and not its Procurement Procedures. Attachment A is silent on change orders exceeding 25%. While MPHA agrees that in professional service contracts for over \$10,000 that Board approval is required for a change order **exceeding** 25%, there is no support for this requirement in Attachment A.

MPHA revised its Procurement Policy on April 24, 2002 and intended that a change order increasing the first year of the contract up to 25% would not require Board approval. MPHA also intended that such a change order would not require MPHA to obtain Board approval to extend the contract for a second year if the Board's initial authorization permitted MPHA to renew a contract for a second year. Also, MPHA intended that it could increase the second year of the contract up to 25% without Board approval. MPHA will amend its Procurement Policy and Procedures and Attachment A to reflect the intent described above.

Seventh, MPHA is reorganizing its Procurement Department. As a result of the reorganization, MPHA has instituted a procedure whereby the Procurement Department provides a monthly report to the Deputy Executive Director on the upcoming deadlines to extend contract dates or limits of authority or to re-solicit. MPHA's goal is to have new contracts in place by the time the old contract expires and to reduce the use of purchase orders between contracts.

3. MPHA's Board of Commissioners approved all contracts with private security guard companies and MPHA's Annual Agency Plans.

MPHA agrees that the Board of Commissioners should approve professional service contracts in excess of \$25,000. All contracts with private security guard vendors were approved by the Board.

The Board approved contracts with the MPD in 1997, 1998 and 1999. Although the Board did not formally approve the MPD contracts in 2001 and 2002, the Board was aware that MPHA was contracting with the MPD. As required by federal law, each year the Board approves the MPHA Agency Plan. (Agency Plan). The Agency Plan includes a five year plan and an annual plan. In the years 2001 and 2002 the Agency Plan also included a Public Housing Drug Elimination Program Plan (PHDEP) template. The PHDEP template references the use of a MPD Public Housing Police Team and the budget, goals and milestones for the police unit. The 2001 and 2002 Agency Plans were respectively approved in July 2000 and July 2001.

As such, the Board either formally approved or was aware of the MPD contracts from 1997 to 2001. On January 28, 2004, the Board approved the 2003 contract and an extension to this contract and a 2004 contract with an option to renew for a second year. MPHA is confident with the reorganization of the Procurement Department that in the future; the Board will approve all professional service contracts in excess of \$25,000.

4. MPHA estimates that by April 2004, it will have procedures in place so that contract awards are reviewed by the Contracting Officer before going to the Board of Commissioners for approval. See MPHA's Response to Executive Summary (C 4).

5. MPHA has procedures to reserve and obligate funds prior to expenditure and retrained staff in April 2003 to improve compliance with the procedures.

MPHA has taken steps to reserve and obligate funds prior to expenditure. See MPHA's Response to Executive Summary (C 9). The Report states that the purpose of obligating funds prior to incurring an expense is to make sure that MPHA has sufficient funds to pay for the services. MPHA notes that it has consistently balanced the budget, receives outstanding scores under the financial indicator according to HUD's Public Housing Assessment System and is fiscally sound.

6. MPHA effectively monitored the performance of supplemental police service contracts.

24 C.F.R. 85.36 (b) (2) states that a PHA "will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions and specifications of their contracts." MPHA's contract administration system for security guard vendors included daily sign in logs, daily activity logs and incident reports which MPHA staff reviewed daily. If there were insufficiencies in the reports, these matters were immediately resolved. MPHA determined whether a guard was properly trained by the way the guard completed the various logs and reports.

MPHA attended monthly Security Advisory Committee (SAC) with staff, tenants, members of the Minneapolis Public Highrise Resident Council (MHRC), and vendors to discuss and resolve security issues. MHRC prepared the minutes of the meetings. In addition, MPHA communicated with the vendors in person, by phone and email on a daily basis and routinely met with each vendor on a weekly basis except for several months towards the end of the 2000 contract with Reco.

MPHA reviewed video tapes of guards on duty to determine whether they were on post or attending to duties while on post. On several occasions, when MPHA determined that a guard was not performing, MPHA asked the vendor to remove the guard from MPHA's account.

MPHA also reviewed invoices and subtracted time for missed or late shifts. Staff, residents and guests also completed Security Guard Complaint Forms which MPHA

reviewed, investigated and resolved. Taken as a whole, these activities were a very efficient and cost effective administration system. The Report's conclusion that this administration system was faulty merely because the minutes to the monthly SAC meetings did state how MPHA evaluated the vendor's overall performance is baseless and unreasonable.

As previously stated, MPHA alleged non-performance as part of a litigation strategy in a very complicated lawsuit. See MPHA's Response to the Executive Summary (C 2). The trial court determined that MPHA had no damages because the guards were on duty for assigned shifts and performed guard services. In fact, MPHA only paid when the guard was on duty. Also if the guard did not perform or the guard's performance did not improve, the guard was taken off of MPHA's account. The court found no evidence of nonperformance.

The Report wrongly concludes that there was nonperformance and offers no evidence to show nonperformance. Even if there was nonperformance the Report offers no basis for calculating the damages at \$168,687. For these reasons the final report should delete any reference to a poor contract administration system, that the vendors did not perform and that MPHA suffered damages.

G. MPHA's RESPONSE TO FINDING 3

1. An ambiguity exists in the three private security guard contracts as to whether MPHA overpaid sales tax in the amount of \$260,923 and these payments are eligible federal costs.

The Report states under Finding 3 that problems occurred because MPHA's Executive Director did not exercise her responsibilities. Yet, the Report offers no examples on how the exercise of an Executive Director's responsibilities in any way is related to the alleged problems. Also, for all of the reasons stated in this Response, MPHA does not agree with all of the findings in the Report.

In particular MPHA notes that: a) the alleged overpayment in sales tax was due to ambiguous contract language. See MPHA's Response to Executive Summary (C 3); b) contract administrator duties were properly segregated; c) in expending funds, MPHA made payments with 99.98% of the contract authority; and d) MPHA revised its check request procedures in April 2003.

At all times, MPHA's Executive Director has properly exercised her responsibilities as shown by MPHA's constant evaluation and revision of policy and procedures before, during and after the audit. In addition the Executive Director provided for the Supervisory Training, the reorganization of the Procurement Department, the restructuring of the duties of the Director of Procurement, revision of written policy, procedures and forms. In addition, under the Executive Director's leadership, MPHA has been designated a high performer since 1997.

2. Reasonable controls existed to mitigate the risk of duplicate payments as shown by overpayments of 0.04% out of \$17 million in expenditures.

No system can provide assurance that duplicate payments will not occur. Every system has a weakness. A PHA must use its limited and dwindling resources efficiently and use reasonable controls depending upon the risk and cost of implementing the control. A PHA must balance the risk and cost of error and the cost of controls to mitigate the error.

MPHA has controls against duplicate payments. The contract administrator reviews and approves the invoice. It is reasonable to assume that the contract administrator will recognize duplicate invoices. Also, the financial software system will not allow an invoice to be entered if the same invoice number has already been entered for the vendor. In addition, if the invoice does not have a number, MPHA stamps a number on the invoice.

These are reasonable and effective controls given the fact that out of \$17 million in expenditures for all supplemental police services, only \$7426 or about 0.04% resulted in duplicate payments. These errors occurred because the contract administrator did not recognize the invoice as a duplicate and the invoice number was different.

However, the supporting documentation shows the amount of overpayment, to whom payment was made and the basis for the overpayment. Based upon the supporting documentation, MPHA will take steps to recover the overpayment from the police officers. Also, MPHA will perform a self audit, using a truly representative sample of payments. If the audit reveals that duplicate payments are occurring in a frequency or in an amount that warrants other controls, MPHA will implement the controls.

MPHA believes that its limited and dwindling resources are best used to implement the changes that the OIG has recommended and to continue to provide quality housing for low income persons. The duplicate payments in the amount of \$7,426 are eligible federal costs because MPHA's policies and procedures give reasonable assurance of avoiding duplicate payments as shown that in payments of over \$17 million, only \$7,426 resulted in over payments which represent 0.04% of the payments. .

MPHA respectfully requests that the recommendation that MPHA reimburse the appropriated program from non-federal funds in the amount of \$7426 be deleted from the Report. See MPHA's Response to Executive Summary (C 1).

3. MPHA revised its procedures for check requests in April 2003. See MPHA's Response to Executive Summary (C 8).

4. MPHA's use of purchase orders resulted in funds being used in an efficient manner.

Without any basis or explanation the Report concludes that the use of a purchase order results in funds not being used in an efficient manner. While MPHA agrees that it should have had formal contract for some of the supplemental police services, the use of a

formal contract has nothing to do with whether the expenditure would have been incurred.

Also, awards to the private security companies resulted from a formal competitive process. In addition, contracts with the MPD and off-duty police services were sole source. Clearly, the purchase orders were an efficient use of funds.

5. MPHA has segregations of contract administrator's duties but has increased the segregation of some functions. See MPHA's Response to Executive Summary (C 7).

6. Since 1996 MPHA's payments exceeded contract authority by 0.02%.

The Report states that MPHA's payments exceeded contract authority by \$82,845. This computation is based upon 9,179 transactions valued at \$244,772,453. In 33 of the 9,179 transactions, MPHA exceeded the contract authority. MPHA has provided documentation to the OIG that shows only 32 transactions totaling \$46,045 was paid in excess of contract authority. This represents less than 0.02% of the total funds contracted. See also MPHA's Response to the Executive Summary (C 9).

To improve on this already very high percentage, MPHA has modified Oracle, its financial software, to hold a payment if it would exceed the contract authority until the authority is increased. This change should eliminate payments exceeding contract authority.

H. CONCLUSION


In the past MPHA's policies and procedures provided for reasonable assurance that supplemental police services were administered according to federal requirements and internal policy and procedure and that resources were safeguarded. However, MPHA is constantly revising policy and procedures to improve the assurance and appreciates receiving suggestions for improvement.

For the reasons stated above, MPHA's current policy and procedures, along with the anticipated future revisions and ongoing evaluations, provide more than reasonable assurance that supplemental police contracts will be administered according to federal requirements and internal policy and procedure and that resources are safeguarded. MPHA respectfully requests that the Report be revised as recommended above.

Carol Kubic, Esq., being duly sworn, states she is the Director of Legal Services for Minneapolis Public Housing Authority (MPHA). She verifies MPHA's Response to the OIG's Draft Audit Report dated January 2004, for and on behalf of MPHA and is authorized to do so. Certain matters in the Response are not within her personal knowledge and there is no officer of MPHA who has personal knowledge of all matters. Authorized employees and counsel of MPHA have assembled the facts in the Response and informed deponent that the facts are true.

Subscribed and sworn to before me
On January 29, 2004

LUCILLE LILLARD
NORTH PUBLIC-MINNESOTA
My Commission Expires Jan. 31, 2005

By 
 CORA MCCORVEY
 Executive Director
 1001 Washington Avenue North
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 (612) 342-1443

HUD Comments

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U.S. Department of Housing and Urban Development

Minneapolis Field Office
920 Second Avenue South
Minneapolis, Minnesota 55402
<http://www.hud.gov/>

January 29, 2004

MEMORANDUM FOR: Heath Wolfe, Regional Inspector General for Audit, SAGA

FROM: *Diane C. Cmel*
Diane C. Cmel, Director, Minneapolis Hub Office of Public Housing, 5KPHSUBJECT: Draft Audit Report -- Minneapolis Public Housing Authority
Supplemental Police Services
Minneapolis, Minnesota

Attached are comments from the Minneapolis Office for your review and consideration prior to issuance of the report. We appreciate the extension granted to us for submission by January 31, 2004.

Thank you for the opportunity to comment.

Attachment

"Welcome Home"

**Comments regarding OIG Audit Report of MPHA supplemental police services
Office of Public Housing, Minneapolis Hub, issued January 2004.**

The following comments are offered for internal consideration prior to the final drafting and not intended to be included in the audit report itself.

Page iii, Executive Summary

Paragraph 1 states the reason for the audit as being to determine whether the complainant's allegation was substantiated. Your findings appear to support this allegation, but paragraph 2 states the opposite, "Supplemental police services contracts were generally awarded through full and open competition."

Both paragraphs 1 and 2 refer to 'supplemental police services'. As per the exit conference with MPHA, we suggest this term be clarified. Is the service actually 'private guard service' or supplemental police services that can only be provided by professional police officers? If it is a service that can only be provided by police officers, does this influence the 'full and open competition'? The draft report does not address the specific service requirements.

The second paragraph states 'Supplemental police services contracts were generally awarded through full and open competition, but contracts were not always executed for the services.' *Contracts were generally awarded through full and open competition* seems to contradict *contracts were not always executed for the services*. Full and open competition, according to MPHA and HUD policy, would require advertising, proposals and contracts; however, the draft report does not reference advertising for bids, bid proposals, Knight Security's bid proposal or how Knight Security was selected and awarded the contract. Although the contract was awarded to Knight Security, most of the payments were made to individuals. This appears to disagree with the terms of the contract, as well as full and open competition. Besides being made to individuals, payments were made based on invoices, rather than a contract bid amount. The report does not reference documentation used to verify that payments were made according to the terms of the contract, or how such a comparison could be made without a written agreement. If payments were not made in accordance with the contract, this also indicates a violation of full and open competition.

Page 2

Paragraph 3 states the scope of the audit was for contracts from 01/01/1996 through 12/31/2002. Bullet #3 in paragraph 5 refers to MPHA Procurement Procedures Manual as revised 04/24/2002. We suggest clarification that procurement requirements in effect for the period audited prior to 04/24/2002 were used to avoid misunderstanding that the revised manual was used for the entire audit period.

Page 4

The second paragraph does not note that a copy of the draft report was provided to the Office of Public Housing, U.S. Department of HUD, Minneapolis Field Office.

Page 6

The second paragraph references requirements of MPHA's Procurement Procedures Manual,

JAN 29 2004 15:02 FR PUBLIC HOUSING

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revised 04/24/2002, but does not indicate if these requirements were changed from those effective for the period audited prior to 04/24/2002.

The last paragraph states \$538,697 in Operating Subsidies was used toward security services. We question how this exact amount was determined, as operating subsidy is based on a formula ~~and goes into the PHA's operating reserve to supplement other PHA income, which is used to~~ pay operating expenses of the PHA. The PHA does not requisition subsidy based on individual expenses. We suggest rewording this to indicate \$xxxx was used from the PHA's Public Housing Operating Reserve.

Page 8

The last paragraph refers to MPHA Procurement Procedures Manual as revised 01/09/2003, but again does not indicate that requirements effective prior to this date were used. It appears this document was revised both 04/24/2002 and 01/09/2003. It is not obvious what the significance is of using the two different dates in different places.

Page 9

The last sentence in the second paragraph should read, "... Authority *lacks* controls...."

The third paragraph discussing the hours worked by off-duty Minneapolis Police Department (MPD) officers notes the hours billed to MPHA exceeds standards set by MPD; however, MPHA is not responsible for monitoring MPD's policies. The policy referenced was revised 05/09/2000. The policy in force on 05/1999, when the overtime work began, is not referenced.

Page 11

1B. Suggest this read "Executes *written* contracts".

Page 13

The last paragraph does not refer to the policy in place between 01/1996 and 03/2002. It references MPHA Procurement Procedures Manual, dated 04/24/2002.

Page 14

The third paragraph references MPHA Procurement Policy, but not effective dates, which is inconsistent with other parts of the draft report.

Page 16

The last paragraph refers to Attachment A, MPHA Procurement Procedures Manual dated 04/24/2002. It does not reference the policy in effect during the audited period prior to this date.

Page 20

As per the exit conference with OIG, HUD and MPHA, the wording in the second paragraph should be changed to reflect that "Documentation provided by MPHA did not support that the reports..."

** TOTAL PAGE.04 **

