CITY OF MABTON
Yakima County, Washington
January 1, 1991 Through December 31, 1992

Schedule Of Findings

1. Public Funds Should Not Be Loaned

The City of Mabton contracts the administration of its U.S. Department of Housing and Urban Development) Community Development Block Grant (CDBG) to Neighborhood Housing Services of Eastern Washington (NHSEW), a local non-profit organization. The CDBG program provides housing rehabilitation services for low income city residents.

During our audit, we noted that, in September 1992, NHSEW made payments totaling $31,357.68 to subcontractors and suppliers of F & F Concrete and Construction, Inc., a contractor providing services under the CDBG program. The executive director of NHSEW, Mr. Kevin Jackson, initiated the payments after the contractor had failed to do so. Of the amount paid, $1,034.81 was from city funds and the remaining $30,322.87 was from CDBG program funds held by NHSEW.

Since the contractor had also been paid the full amount of the construction contracts it was his responsibility to satisfy payment of the subcontractors and suppliers. As a result, we consider the $31,357.68 to be an inappropriate expenditure of city and grant funds. This conclusion is supported by a letter dated November 3, 1992, from the NHSEW executive director to the mayor of the City of Mabton which states that the contractor admitted his responsibility for the costs and offered to negotiate a note for repayment of the moneys. Although the contractor agreed to a repayment he also contended that all moneys received had been expended on the projects. We reviewed documentation prepared by NHSEW personnel as a result of an investigation they performed of the contractor's records, however, they failed to support the contractor's contentions.

To increase NHSEW cash flows the executive director submitted a request, dated November 13, 1992, to the grantor for reimbursement of $26,210.35 of these payments. Subsequently, NHSEW was notified that the reimbursement was denied because the expenditures constituted a double payment.

On November 25, 1992, the contractor signed a promissory note to NHSEW requiring monthly payments for a period not to exceed 30 years.

In August 1993, the contractor told NHSEW that he was unable to repay the money and would file bankruptcy. As of January 1994, no payments have been received from the contractor.

Article VIII, Section 7 of the *Constitution of the State of Washington* states in part:

> No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary

support of the poor and infirm . . . .

The NHSEW attorney stated that the contractor merely underbid the projects and that all payments were to satisfy necessary construction expenses incurred. They also stated that the payments were disbursed with the reasonable expectation that each was reimbursable under the CDBG contract. However, in our opinion, as further described in the finding contained in the single audit section of this report, it appears these payments resulted from inadequate administrative controls over the CDBG program.

The payment by NHSEW of the contractor's obligations and the ensuing promissory note are in violation of the legal requirements cited.

We recommend that the city recover, from Neighborhood Housing Services of Eastern Washington, the $31,357.68 of city and grant funds which were improperly loaned to (paid on behalf of) F & F Concrete and Construction, Inc.

CITY OF MABTON
Yakima County, Washington
January 1, 1991 Through December 31, 1992

Schedule Of Federal Findings

1. Grant Administrative Controls Should Be Improved

As discussed in the finding contained in the management section of this report, the City of Mabton contracts the administration of its U.S. Department of Housing and Urban Development) Community Development Block Grant (CDBG) to Neighborhood Housing Services of Eastern Washington (NHSEW), a local non-profit organization. Based upon the conditions disclosed in that finding we performed a review of three applicable project construction files and noted the following concerns:

Project 92-01

Construction Change Order No. 1 was not signed by the homeowner or NHSEW personnel and Change Order No. 2 was not signed by the homeowner.

The final Contractor Payout Order, including retainage, was paid, however the Certificate of Completion of Contract was not signed by the homeowner or NHSEW personnel and the project file had no evidence of assurances against liens by suppliers and subcontractors.

Project 92-02

Contractor Payout Order No. 2 did not indicate the percentage of completion of the project. Payout Order No. 3, which was signed by the executive director of NHSEW, indicated the percentage of project completion as being only 60 percent, however, it authorized payment of 100 percent of the contract less a 10 percent retainage.

The final Contractor Payout Order in the amount of $8,107.45, including retainage, was paid approximately 45 days before a Certificate of Completion of Contract was prepared. We also noted that this final payout order was not signed by the homeowner and the project file had no evidence of assurances against liens by suppliers and subcontractors. In fact, we determined that prior to the final payout, NHSEW was told by the contractor that there was approximately $16,000.00 owed to project suppliers and subcontractors.

Subsequent to the final payout an additional check for $500.00 was issued by NHSEW payable to the contractor and homeowner. This check had a notation of "final payout," however, per our review of the project file and inquiry of the NHSEW executive director, we were unable to determine the reason for this payment. The check was written on a special bank account of NHSEW and does not appear to have been paid with city or grant funds.

Project 92-03

Contractor Payout Order No. 2 authorized payment of 95 percent of the contract amount, however, it did not indicate the percentage of completion of the project and was not signed by NHSEW personnel.

On September 17, 1992, Payout Order No. 3 and final Payout Order No. 4, totaling $7,170.91, were paid. However, the Certificate of Completion of Contract was not prepared until approximately two months later and it was only signed by the NHSEW executive director and not the homeowner. We also noted that the project file had no evidence of assurances against liens by suppliers and subcontractors. In fact, we determined that prior to these two payouts, NHSEW was told by the contractor that there was approximately $12,500.00 owed to project suppliers and subcontractors.

Subsequent to the final Contractor Payout Order an additional check for $1,908.75 was issued on November 2, 1992, by NHSEW payable to the contractor and homeowner. This check had a notation of "final payout," however, per our review of the project file and inquiry of the NHSEW executive director, we were unable to determine the reason for this payment. The check was written on a special bank account of NHSEW and does not appear to have been paid with city or grant funds.

On January 4, 1993, the homeowner advised NHSEW that various work was incomplete, including no insulation in the ceilings or floors.

A written agreement between the homeowner and contractor was used for each of these construction projects. This agreement required in part:

> All project changes are to be authorized by a written change order signed by the Homeowner and NHSEW.
>
> Prior to any contractor payments the Homeowner and NHSEW Construction Manager are to inspect the completed work.
>
> Contractor Payout Orders are to be certified by the Homeowner and an agent of NHSEW. The final payment, less retainage, shall be paid within 5 days of the date of the Certificate of Completion . . . subject to the condition that final payment shall not be due until the Contractor has delivered to Homeowner (a) Contractor's sworn statement identifying all suppliers of labor, supplies or materials, and the gross amount of all charges made by each . . . (c) A complete release of all liens arising out of the Project, or receipts of full payment covering all labor, materials, and equipment for which a lien could be filed, or in the alternative, a bond satisfactory to Homeowner indemnifying Homeowner against any and all such liens.
>
> Retainages shall not be paid in less than thirty days following the issuance of the Certificate of Completion.

A written agreement between NHSEW and the contractor was also used for each project. This agreement also required, in part, that the final payment was not due until the contractor delivered to the homeowner a complete release of all liens arising out of the project, or receipts in full covering all labor or materials for which a lien could be filed.

The United States Office of Management and Budget (OMB) Circular A-87, *Cost Principles*, established standards for documentation and allowability of costs chargeable to federal grant programs. Among those standards are:

> . . . Costs must be necessary and reasonable for proper and efficient administration of the grant program . . . .

The above conditions resulted because NHSEW personnel did not comply with CDBG program requirements. In a letter dated, August 13, 1992, the NHSEW executive director admitted that he had personally erred and processed over $21,000 to the contractor without the approval of the construction manager. The executive director indicated that he was worried that the contractor was carrying a credit on materials and labor not yet done, and might be tempted to use this gain on other projects and fall behind on NHSEW's.

NHSEW's failure to properly administer the CDBG construction program resulted in the contractor not completing the scope of his work or paying his suppliers and subcontractors. Also, as discussed in the finding contained in the management section of this report, we question the expenditure of $30,322.87 of CDBG program funds for the payment of the contractor's obligations to his suppliers and subcontractors.

<u>We recommend</u> that the city improve the administrative controls over its Community Development Block Grant program and recover the $30,322.87 of questioned costs described in the finding contained in the management section of this report.