

September 21, 1998

Internal Audit Report 98-13
Community Development Block Grant Administration
Community Planning and Development

Introduction. The Municipality of Anchorage (recipient) applies for and receives annual entitlement funds from the United States Department of Housing and Urban Development (HUD) through the Community Development Block Grant (CDBG) program. The primary objective of the grant program is the development of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low- and moderate-income. The CDBG fund uses include activities such as capital projects, housing rehabilitation, and public services. Capital projects are selected through a solicitation process that emphasizes compliance with HUD's National Objectives and consistency with the Housing and Community Development Consolidated Plan and other requirements. The Housing and Community Development Division is responsible for administering the program and ensuring that CDBG funds are used in accordance with HUD requirements.

Scope. The objective of this audit was to determine whether the Housing and Community Development Division was administering CDBG capital projects in accordance with applicable HUD guidelines contained in Title 24 Code of Federal Regulations (CFR) Part 570 "Community Development Block Grants" (Entitlement Program). Specifically, we reviewed project eligibility, project monitoring procedures and project expenditures for compliance with federal requirements. Our review of project eligibility was for capital projects approved for funding from the 1997/1998 entitlements. Our review of capital projects for evidence of monitoring, expenditure test work, and documentation requirements was for both 1997/1998 capital projects and seven 1996 capital projects funded with 1995 and 1996 entitlements. The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control

review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of May through July 1998. The audit was requested by the Assembly.

Overall Evaluation. Projects approved for funding from 1997/1998 entitlements were for eligible types of activities of the CDBG program based on proposed descriptions of the project provided by the sub-recipients as part of the Request for Proposal Process. However, procedures for monitoring sub-recipient compliance with HUD regulations and contract requirements required strengthening. Further, in 1998, some grant funds were disbursed to sub-recipients in advance, which was not an allowable method of disbursement. We also found that some project expenditures were not always properly supported.

FINDINGS AND RECOMMENDATIONS

1. Grant Funds Not Disbursed in Accordance With the CFR and With the Contract Requirements.

- a. Finding.** Grant funds for some capital projects were not disbursed in accordance with 24 CFR Part 85, contract requirements, and Municipal procedures. Funds in the amount of \$1,111,638 had been disbursed to six capital projects (five 1997 capital projects and one 1996 capital project) as advance payments to the sub-recipients. Five of these were for the full amount of the award. This was not an authorized method of disbursement per 24 CFR 85.21 - Payment. In addition, five of the sub-recipients were required by their contracts with the Municipality to establish an escrow account for the grant funds, however, disbursement checks were made payable to the sub-recipient rather than an escrow agent and there were no escrow agreements in the grant files prior to fund disbursement. These payments were made between April and May 1998. We also noted that the disbursements were paid via

“request for voucher check” rather than through the purchase order method of payment as required by Municipal Policy and Procedure 24-19. The reason this occurred was because purchase orders had not been established for the grant contract awards.

- b. Recommendation.** Future disbursements should only be made in accordance with HUD regulations, contract requirements, and Municipal policy and procedures. Current projects that have received advanced grant funds should be closely monitored to ensure compliance with Federal requirements of the grant.
- c. Management Comments.** Management stated, “24 CFR Part 85 makes reference to “immediate needs” of the grantee as grounds for disbursing funds. At the time the contracts for 1997 capital projects were drawn up, our interpretation of “immediate needs” encompassed the need to fulfill a contractual obligation with a subrecipient organization. Subsequently, we were advised by HUD that the “immediate needs” provision extended to subrecipients, as well.

“It is permissible under Part 85 to disburse funds in lump sum when necessary to consummate a real estate transaction or if funds must be on deposit as a condition of another grantor participating in a project, such as a state agency. For example, funds advanced to the Muldoon Community Development Corporation were appropriately expended immediately by MCDC for a long-term lease payment as required by their contract. A substantial portion of the grant disbursed to Habitat for Humanity was also passed out as payment for a real estate acquisition.

“Corrective Action: We recognize the identified issues, consequently, all contracts that had not yet had funds disbursed have been revised to reflect a fund disbursement model to ensure compliance with Part 85. All future contracts will provide for

incremental fund disbursement, based on an impartial assessment of the degree of risk and complexity involved in each project. Using an “underwriting” approach similar to the method employed by financial institutions to manage construction loans, one of three basic models will be employed: 1) Disbursement of funds to subrecipient based on reasonable documentation of immediate need for funds, such as contracts and invoices for services and materials required by the project. Subrecipient would be responsible for payments to contractors and suppliers; 2) Disbursement of funds on a cost-reimbursable basis only, when subrecipient has access to sufficient working capital and presents acceptable documentation of expenses paid for the project; or 3) Direct disbursement of funds by the Municipality to contractors, sub-contractors and suppliers engaged by the subrecipient, based on presentation of invoices to the Municipality for payment. Each contract will specify the terms of disbursement.

“The use of escrow accounts was a requirement imposed by this Department, not by HUD. This approach turned out to be problematic, and not the most effective method of ensuring that subrecipients appropriately expended funds. Consultation with local financial institutions on this matter reveals that this was not a reasonable requirement, except in cases where an escrow account is established to hold investments from multiple parties for a specific project.

“Corrective Action: We will revise all contracts according to the feasibility and appropriateness of an escrow account.

“We appreciate your pointing out our error in making disbursements via “request for voucher check” rather than through the purchase order method as required by Municipal Policy and Procedure 24-19. All but one of the staff of the Housing & Community Development Division have been in their current positions less than two

years, and previous management did not leave behind sufficient instructions for program administration.

“Corrective Action: All staff involved in the process of fund disbursement have been advised of the proper policy and procedure. A desk manual is being prepared, outlining specific procedures for evaluation and payment of invoices, disbursement of grant funds and other tasks related to CDBG program management. We would appreciate IAD review of the desk manual upon its completion and annually thereafter to ensure that procedures accurately implement Municipal policies and protect the CDBG investment. We expect to have a draft of the manual complete by December 15, 1998.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.
2. **Procedures for Monitoring Sub-recipient Compliance Required Strengthening.**
 - a. **Finding.** Procedures for monitoring sub-recipient compliance with HUD regulations and contract requirements were not adequate. Our review of 1996, 1997 and 1998 capital projects revealed that Housing and Community Development personnel had not verified the sub-recipient’s eligibility by determining whether projects primarily serviced low- and moderate-income persons prior to entering into a contract with the sub-recipient and disbursing funds. In addition, monitoring was not being performed to ensure that the sub-recipients were actually serving the intended low- and moderate-income clientele. These projects were in the limited clientele of low- and moderate-income persons category. In our opinion, monitoring actions during the project and before full disbursement of funds protect the Municipality from the risk

of improper expenditure by the sub-recipient and lessen the chance for litigation to recover funds that have been spent improperly.

- b. **Recommendation.** Monitoring of sub-recipient performance, including the verification of the sub-recipient's eligibility, should be performed prior to the full disbursement of grant funds and during the project performance period.

- c. **Management Comments.** Management stated, "Eligibility of the subrecipient, the project and the population to be served are all evaluated by staff in a threshold review of capital project applications. Applications from ineligible sponsors, which propose ineligible activities, or which do not provide adequate explanation of how eligibility will be documented once the project is implemented are not forwarded to the Housing & Neighborhood Development Commission for review and consideration for funding. This review was conducted for each of the 1997 and 1998 capital projects, however, appropriate documentation was not included in the project files.

Corrective Action: We are in agreement with IAD that project monitoring has been a long-term weakness in the CDBG program. Documentation of threshold eligibility review will be contained in each file. A monitoring guide to ensure that the capital project is developed in accordance with applicable regulations and requirements will be placed in each file, and completed to demonstrate project progress and compliance, based on field observation and documentation submitted to the Municipality by the subrecipient. All subrecipients will report on actual clientele served by the project six months after the project is placed in service, or by July 31 for the year ending June 30, whichever comes first. Thereafter reports will be submitted once per year, by July 31, for a period of five years for non-profit subrecipients, in perpetuity for Municipal departments. All future contracts will reflect this requirement. During project start-up, staff may visit agencies with less

established programs to verify on-site that appropriate recordkeeping systems are in place to ensure compliance with reporting requirements. Relative risk will be evaluated using an impartial scoring tool developed by the U.S. Department of Housing & Urban Development. Project files will contain documentation of any such on-site visits and monitoring results. The monitoring guide will be completed in draft form by December 15, 1998. We would appreciate an advisory review by Internal Audit before the guide is finalized.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Some Grant Expenditures Were Not Allowable by Federal Requirements and Some Expenditures Were Not Always Properly Supported.**

- a. **Finding.** Some project expenditures were not allowable or supported in accordance with contract requirements and/or OMB Circular A-87 requirements. Specifically, the following was noted:

- 1) Permit fees totaling \$2,903.60 were paid for one project although the contract specified that the fees for required permits and approvals of regulatory agencies would be paid by the sub-recipient.
- 2) Three invoices for items paid with CDBG funds for one project were not allowable project costs. These items included antifreeze, a head lamp, and a tire with labor totaling \$174.87. These items were purchased by the contractor and appeared to be their overhead items, not chargeable to the project.

- 3) One invoice was paid based on the purchase order amount rather than the invoiced amount, resulting in an overpayment of \$20.
- b. **Recommendation.** Only allowable project expenditures should be paid by grant program funds and all project expenditures should be properly supported.
- c. **Management Comments.** Management stated, "1. Permit fees for the Chugiak Senior Center are, indeed, the responsibility of the Department of Health & Human Services. This project was completed in May, but we had not requested reimbursement of permit fees by DHHS.

Corrective Action: By September 18, 1998, we will request reimbursement of permit fees by DHHS, and complete close-out of the project.

"2 & 3. Both invoices in question were originally reviewed by other municipal departments involved in managing CDBG capital projects. We realize that although these project managers may be able to verify as to whether the work indicated was done or materials received, they are not in a position to certify as to the eligibility of the charges under CDBG rules.

Corrective Action: Effective immediately, all incoming payment requests, regardless of the originating department, will be reviewed by staff to ensure CDBG eligibility. Procedures will be documented in a desk manual to ensure continued diligence in this area in case of staff turnover. The Administrative Officer will be responsible to see that this procedure is observed. The questioned costs are allowable program administration costs, and will be coded to that org, rather than to capital projects.

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on September 9, 1998.

Audit Staff:
Amy McCollum, CIA
Margie Goodrich, CIA