



U.S. Department of Housing and Urban Development  
Great Plains Office of District Inspector General  
for Audit, 7AGA  
Gateway Tower II - 5<sup>th</sup> Floor  
400 State Avenue  
Kansas City, Kansas 66101-2406

AUDIT MEMORANDUM  
2002-KC-1801

February 25, 2002

MEMORANDUM FOR: William B. Rotert, Director, Office of Community Planning and  
Development, 7AD

*Roger E. Niesen*

FROM: Roger E. Niesen, District Inspector General for Audit, 7AGA

SUBJECT: Review of Enhanced Enterprise Community Funding  
Kansas City, Kansas

We have completed a review of the Enhanced Enterprise Community funds awarded to the City of Kansas City, Kansas in 1994. We performed this review to address a citizen complaint received by our office. We reviewed the City's selection of Enhanced Enterprise Community subrecipients with the purpose of answering the complainant's questions and therefore, did not review any other aspects of the City's Enhanced Enterprise Community program.

We did not identify any specific violations of HUD regulations; however, we did determine that the City cannot fully support its administration of the Enhanced Enterprise Community funds. Because the City has not maintained an adequate recordkeeping system, the City does not have adequate support for actions taken and decisions made regarding the funds. As a result, HUD, the Mayor/Chief Executive Officer, the City Council, and the public lack assurance that the City administered these funds according to applicable regulations and guidelines, and in an efficient, effective, and fair manner.

Within 60 days please provide us, for each recommendation in this report, 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. 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 me at (913) 551-5870.

## **Background**

HUD's Enterprise Community programs were designed to address severe community problems such as high unemployment, crumbling infrastructure, and minimal access to business capital. In late 1994, HUD designated a geographical area within the City as an Enhanced Enterprise Community, known as the Zone. To address the community problems within the Zone, HUD awarded \$15.6 million in Economic Development Initiative grants and Section 108 loan guarantees to the City.

The City ultimately concentrated the \$15.6 million into a Zone Development Fund that consisted of three programs:

- Project Development Program
- Job Development Program
- Small Business Development Program

The City formed the Zone Development Team, a group of civic leaders, Zone business owners and residents, to assist it in administering the Enhanced Enterprise Community funds. The City also implemented internal procedures to administer the HUD funds as follows:

Individuals and businesses submit to the City an application requesting access to the HUD funds to be used to enhance the Zone. The City staff then conducts a preliminary analysis of the application to ensure completeness and determines basic eligibility. The Zone Development Team then evaluates applications that are complete and meet basic eligibility requirements, and makes approval or rejection decisions. The Zone Development Team forwards recommended applications to the City Council for final review and approval or rejection.

According to City records, the City used, or is in the process of using, the Enhanced Enterprise Community funds to redevelop businesses along an inner City street, expand a manufacturing business, develop a downtown hotel, and for costs associated with operating the Zone Development Fund programs.

## **Objectives, Scope and Methodology**

The overall review objective was to evaluate the complainant's concerns and answer the questions posed in the complaint. We reviewed the City's process for selecting Enhanced Enterprise Community subrecipients. We did not review any other aspects of the Enhanced Enterprise Community program.

To achieve our objective, we reviewed City files, HUD's local and headquarters files, HUD guidelines, and Federal rules and regulations that govern the Enhanced Enterprise Community program. We interviewed the complainant, current and former City staff, HUD officials, and others from the local community. The review covered the \$15.6 million in Enhanced Enterprise Community funds awarded to the City in 1994.

## Audit Results

We did not identify any specific violations of HUD regulations; however, we did determine that the City cannot fully support its administration of the Enhanced Enterprise Community funds. Because the City has not maintained an adequate recordkeeping system, the City does not have adequate support for actions taken and decisions made regarding the funds. As a result, HUD, the Mayor/Chief Executive Officer, the City Council, and the public lack assurance that the City administered these funds according to its regulations and guidelines, and in an efficient, effective, and fair manner.

Grantees, such as the City, must comply with applicable Codes of Federal Regulations. 24 CFR 85.42 and 24 CFR 570.502 require grantees to maintain financial and programmatic records, supporting documents, statistical records, and other records pertinent to program regulations or the grant agreement for a period of four years from the date of the submission of the last expenditure report, as authorized by HUD.

24 CFR 570.506 requires grantees to establish and maintain sufficient records to enable the Secretary to determine whether the recipient met the requirements of the Community Development Block Grant program. At a minimum, grantees must maintain records providing a full description of each activity assisted (or being assisted) with Community Development Block Grant funds, including its geographical location, the amount of Community Development Block Grant funds budgeted, obligated and expended for the activity, and the provision under which it is eligible. The statute also requires grantees to maintain evidence to support how the Community Development Block Grant funds provided to subrecipients are expended, including any documentation appropriate to the nature of the activity.

The City cannot adequately support its administration of the Enhanced Enterprise Community funds because it:

- cannot provide minutes of all meetings of the Zone Development Team, the group designated by the City to assist it in administering the funds;
- did not maintain a register or log of applications submitted for Enhanced Enterprise Community funds;
- cannot adequately document all of the citizen applications it received for private business loans; and
- cannot support its underwriting review of a business venture that ultimately received \$4.2 million of the Enhanced Enterprise Community funds.

The City does not have a complete record of the meetings and ensuing discussions and decisions made by the Zone Development Team. The minutes of meetings that the City does have make reference to other meetings for which the City cannot provide minutes. As a result, we were unable to assemble a complete history of decisions made by the Zone Development Team. A complete history of the City's processing of applications is important to answer challenges and provide assurance the funds were appropriately awarded.

The City did not maintain a register or log of the applications submitted for Enhanced Enterprise Community funds. The City provided a list of 18 applications it said it received requesting the Enhanced Enterprise Community funds. A former City employee told us that the City received over 200 applications. This same former employee provided to us a list of 31 names of individuals he said had applied for Enhanced Enterprise Community funds while he was still an employee of the City. Because the City did not maintain a register or log of applications, we have no way to determine whether the list of 18 applicants is accurate, or whether the City actually received more applications.

Additionally, the City does not have records to support all 18 applications it said it received. We selected a sample of five and found the City was not able to locate any records for one of the applicants.

The City also cannot support its efforts to evaluate the feasibility of a business venture that ultimately received \$4.2 million of the HUD funds. The business venture was the first project funded with the Enhanced Enterprise Community funds and was intended to expand an existing business that would create jobs for Zone residents. City staff said the Zone Development Team and City staff evaluated the proposal using underwriting criteria commonly used by the Small Business Administration and conventional and private lenders, and HUD rules and regulations. However, the City cannot provide any documentation to show how it applied the criteria in the decision-making process.

### **Auditee Comments**

*[HUD awarded the Enhanced Enterprise Community funds to the City of Kansas City, Kansas in 1994, but since that time the City government has become known as the Unified Government.]*

Excerpts from the Unified Government's comments on our draft finding follow. Appendix A contains the complete text of the comments.

*Minutes were produced for all meetings of the Zone Development Team where action on loans took place. Other meetings were held during the formative stages of the Zone Development Team and where training was conducted. Minutes were not taken since there was no substantive action regarding the administration of the Enhanced Enterprise Community Funds. Minutes of such meetings were not required by any statute, rule or regulation identified by the Office of Inspector General for Audit.*

### **OIG Evaluation of Auditee Comments**

24 CFR 85.42 and 24 CFR 570.502 require grantees, such as the City, to maintain financial and programmatic records, supporting documents, statistical records, and other records pertinent to program regulations or the grant agreement for a period of four years from the date of the submission of the last expenditure report, as authorized by HUD. In addition, 24 CFR 570.506 requires grantees to establish and maintain sufficient records to enable the Secretary to determine whether the recipient has met the requirements of the Community Development Block Grant program. Minutes of meetings of the Zone Development Team, the group tasked with making

major decisions regarding the Enhanced Enterprise Community funds, are inherently important to support decisions made and actions taken on the Federal funds. The lack of minutes for meetings held where there was no substantive action taken does not mean the Team did not discuss important issues or make decisions that are an important part of the project history. Without a complete record of meeting minutes, HUD, the City, and City residents have no assurance that funds are properly administered.

### **Auditee Comments**

*The Unified Government disputes the allegation or inference that applications other than those identified were received. A system was in place to receive, process, and track progress on applications through frequently held meetings of the Department of Development staff and status reports generated. As the Enhanced Enterprise Community Program progressed, a detailed application, approved by HUD, was developed and utilized. Mere inquiries regarding the program or eligibility received a response but were not considered as applications.*

*Given the limited number of applications received, a register or log was not maintained and such is not required by any statute, regulation or rule identified by the Office of Inspector General for Audit.*

*The system is being refined through the development of an Access database for the collection and management of program data for Community Development Block Grant, Section 108 loan guarantee, Enhanced Enterprise Community, HOME Investment Partnership Program and other programs. A consultant was hired in September 2001 to create a program-wide system of collecting and maintaining data so that it is accessible to staff. Such a system will standardize record keeping, allowing for inter-program cross-referencing, and greatly facilitate reporting requirements.*

*The Unified Government provided a list of all 18 loan applicants received for the Enhanced Enterprise Community Funds. As indicated above, mere inquiries regarding the program or eligibility received a response but were not considered as applications. Complete records for one applicant were not produced, although sufficient information to identify the applicant was provided. The Unified Government is in the process of locating and assembling additional documentation with respect to this applicant, which will be provided for review.*

### **OIG Evaluation of Auditee Comments**

We acknowledge there is not a specific requirement to maintain a register or log; however, 24 CFR 85.42 and 24 CFR 570.502 require grantees to maintain financial and programmatic records, supporting documents, statistical records, and other records pertinent to program regulations or the grant agreement for a period of four years from the date of the submission of the last expenditure report, as authorized by HUD. In addition, 24 CFR 570.506 requires grantees to establish and maintain sufficient records to enable the Secretary to determine whether the recipient has met the requirements of the Community Development Block Grant program.

On three separate occasions, current City staff reported different totals of the number of applications received. In addition, a former City employee claims that the City received over 200 applications. Without a register or log of Enhanced Enterprise Community applications received, we have no way to determine how many applications the City actually received.

The City's response said the City is developing an Access database to collect and manage program data. If the City follows through with developing and implementing the database, and it tracks applicants for Federal funds, it should help resolve the record keeping problems noted in our review.

### **Auditee Comments**

*The Unified Government did in fact use standard underwriting principles in its review and processing of the first application received and approved for EEC funding. The City's DRAFT Section 108 Application and Closing Process procedures required that staff obtain appropriate financial information including: (1) uses and sources of funds, (2) 3 year projections and cash flow statements, (3) personal and corporate financial statements, (4) experience of developer, (5) market studies. The City staff also attended HUD sponsored training on the Section 108 Loan program. The materials generated by the training program contained debt coverage ratios and loan to value ratios that served as guides in analysis of this first loan. The materials produced for training also suggested using a checklist for use in financial analysis. While a checklist showing analysis of all the information received cannot be produced 5 years after the fact, many meetings were held with HUD staff in both the Regional and National Offices on underwriting issues. The regulations did not mandate adoption by a municipality of rigid underwriting guidelines and none were imposed by either the Regional or National HUD staffs, but both the loan application submitted to HUD and the final loan documents reflect analysis of underwriting guidelines appropriate to reduce risk to the City and to insure compliance with the National Objectives of the Housing and Community Development Act.*

### **OIG Evaluation of Auditee Comments**

We agree that Federal regulations did not mandate the use of specific underwriting guidelines. The City asserted that its staff followed standard underwriting principles as well as internal procedures in its review and processing of the first application received and approved for Enhanced Enterprise Community funding. Specifically, the City said it used underwriting criteria commonly used by the Small Business Administration and conventional and private lenders. Although we considered the underwriting principles of such entities reasonable criteria, the City's records did not contain documentation of how it used these principles to evaluate the applicant information.

Further, in its response, the City asserted that its staff followed DRAFT Section 108 Application and Closing Process procedures to guide its evaluation of loan applications received. However, these internal procedures were dated and transmitted to staff in July 1996, two months after the first application was submitted to HUD in May 1996. Therefore, the internal procedures presented in the City's response do not appear valid as criteria for evaluating and processing the first business loan application. Even if the City used these or similar internal procedures in

evaluating the first business loan approved, the City's records did not contain documentation to show how the criteria was used to evaluate the applicant information.

### **Recommendations**

We recommend the Director, Office of Community Planning and Development:

- 1A. Ensure the City establishes and implements a system to collect and manage HUD-related program data. The system should be designed to ensure the City can adequately support the administration of HUD funds.
- 1B. Take appropriate administrative actions if the City does not provide the records necessary to demonstrate that it is administering HUD funds according to Federal regulations.

# Auditee Comments



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February 1, 2002

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Office of Inspector General for Audit  
Great Plains District, 7AGA  
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400 State Avenue  
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Dear Mr. Niesen:

Under cover of this letter please find the Unified Government of Wyandotte County/Kansas City, Kansas's comments to the draft audit findings resulting from your review of the City's administration of the Enhanced Enterprise Community funding awarded to the City by HUD. These comments have been prepared by Mr. LaVert Murray, Director of Development, with assistance from the Unified Government's Office of Chief Counsel.

I regret that I was not able to personally attend the conference on January 18, 2002, with Mr. Ronald Hosking, Ms. Kim Randall, and Ms. Shanna Gullede. Mr. Murray, and Ken Moore and Casey Boudreau, representing the Office of Chief Counsel, reported that the conference helped clarify many of the major concerns I had with the draft report. They informed me that Mr. Hosking stated that the review by the Office of Inspector General did not reveal any violations of Federal statutes or rules and regulations. As stated in the bullets contained on page 5 of the draft audit report, the major finding was that the Unified Government cannot provide adequate records regarding four (4) specific areas. The attached comments address each of the four (4) areas.

The heading of the draft finding states that the "City of Kansas City, Kansas Cannot Adequately Support Its Administration of Enhanced Enterprise." After review of the report and extensive discussion with staff, I request modification of that caption to reflect the actual finding of the report that the Unified Government could improve documentation and record retention policies in four areas, and that no violation of statute or HUD rules or regulations were found.

I want to give you my assurance that it is our policy that response to any inquiry of your office be given the highest of priorities. I extend my apologies to you and your office if that did not always occur during the review process.

Sincerely,

Dennis M. Hays  
County Administrator



# Auditee Comments

## **UNIFIED GOVERNMENT'S RESPONSE TO DRAFT HUD INSPECTOR GENERAL'S FINDING DATED JANUARY 9, 2002**

The proposed finding infers that the City of Kansas City, Kansas (now known as the Unified Government) is incapable of administration of Enhanced Enterprise Community Funds. This appears to be based solely upon the assertion that the Unified Government cannot provide documentation, which auditors thought necessary but which was not required by statute, regulation, or rule, in four (4) specific areas. The Unified Government's response addressing each of those four (4) areas is set forth below.

In reality the Inspector General's finding is that no violation was found concerning the administration of the Enhanced Enterprise Community Funds but that the Unified Government could improve documentation and record retention policies. The recommendations to HUD should likewise reflect this finding and acknowledge the steps taken by the Unified Government outlined below intended to accomplish this objective.

*I. The Unified Government provided minutes of all substantive meetings wherein the Zone Development Team acted with respect to loan applications.*

Minutes were produced for all meetings of the Zone Development Team where action on loans took place. Other meetings were held during the formative stages of the Zone Development Team and where training was conducted. Minutes were not taken since there was no substantive action regarding the administration of the Enhanced Enterprise Community Funds. Minutes of such meetings were not required by any statute, rule or regulation identified by the Office of Inspector General for Audit.

*II. The Unified Government appropriately received and processed applications.*

The Unified Government disputes the allegation or inference that applications other than those identified were received. A system was in place to receive, process, and track progress on applications through frequently held meetings of the Department of Development staff and status reports generated. As the Enhanced Enterprise Community Program progressed, a detailed application, approved by HUD, was developed and utilized. Mere inquiries regarding the program or eligibility received a response but were not considered as applications.

Given the limited number of applications received, a register or log was not maintained and such is not required by any statute, regulation or rule identified by the Office of Inspector General for Audit.

Reference was made to a "former City employee" who alleged that over 200 applications were received. A list of 31 named applicants was provided to the auditors

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but which were not shared with Unified Government staff. Perhaps those individuals made inquiry regarding the program, but, as indicated above, did not provide sufficient information to constitute an application. An opportunity to review the list will facilitate the Unified Government's response to this allegation.

The system is being refined through the development of an Access database for the collection and management of program data CDBG, Section 108, EEC, HOME and other programs. A consultant was hired in September 2001 to create a program-wide system of collecting and maintaining data so that it is accessible to staff. Such a system will standardize record keeping, allowing for inter-program cross-referencing, and greatly facilitate reporting requirements.

### *III. The Unified Government documented citizen applications for loans.*

The Unified Government provided a list of all 18 loan applicants received for the Enhanced Enterprise Community Funds. As indicated above, mere inquiries regarding the program or eligibility received a response but were not considered as applications. Complete records for one applicant were not produced, although sufficient information to identify the applicant was provided. The Unified Government is in the process of locating and assembling additional documentation with respect to this applicant and, which will be produced for review.

### *IV. City Can Provide Documentation of Underwriting Review.*

The Unified Government did in fact use standard underwriting principles in its review and processing of the first application received and approved for EEC funding. Attached is a memorandum dated July 29, 1996, from Dean Katerndahl, Director of Development, to various City staff members transmitting a DRAFT Section 108 Application and Closing Process. In the memo Mr. Katerndahl indicated he would send the Process to HUD Regional Office for their review, but would begin using the Process immediately. In paragraph 2 of the Process it was required that staff obtain appropriate financial information including: (1) uses and sources of funds, (2) 3 years projections and cash flow statements, (3) personal and corporate financial statements, (4) experience of developer, (5) market studies. Examination of the Section 108 Application (attached) for the first application received and approved for EEC funding contains corporate 1994 and 1995 financial statements and 1996 to 2000 Projected Financial Statements and Assumptions as well as additional cash flow analysis. It also contains a document entitled credit application listing references and account payable contacts. On February 29-March 1, 1996, City staff attended HUD sponsoring training on the Section 108 Loan program conducted by Roger Frankoff, Development Solutions. The materials generated by the training program contained debt coverage ratios and loan to value ratios that served as guides in analysis of this first loan. The materials produced for training also suggested using a checklist for use in financial analysis. While a checklist showing analysis of all the information received cannot be produced 5 years after the fact, many meetings were held with the HUD staffs in both the Regional and National Offices on underwriting issues. As the result of those meetings and HUD review the terms of the

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loan was substantially modified. The final contract for Loan Guarantee Assistance between HUD and the City of Kansas City, Kansas at paragraph 15 contains extensive "Special Conditions and Modifications." These "Special Conditions and Modifications" were reflective of the underwriting analysis conducted by both the local city staff and the staff of the National Office of HUD. Local flexibility was emphasized as a component of the EDI/108 Loan program. The regulations did not mandate adoption by a municipality of rigid underwriting guidelines and none were imposed by either the Regional or National HUD staffs, but both the loan application submitted to HUD and the final loan documents reflect analysis of underwriting guidelines appropriate to reduce risk to the City and to insure compliance with the National Objectives of the Housing and Community Development Act.

At the exit conference held on January 18, 2002, it was indicated that the Director of Development was responsive while the audit staff of the Office of Inspector General was on site from June to November 2001, but was unresponsive during the time period between December 7, 2001 and January 10, 2002, to answer the audit staff's additional questions concerning underwriting analysis. The Unified Government Staff apologizes for any inconvenience this may have caused.

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## Distribution Outside of HUD

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Director, Housing and Telecommunications Issues, United States General Accounting Office,  
441 G Street NW, Room 2T23, Washington, DC 20548

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B373 Rayburn House Office Building, Washington, DC 20515

Chief, Housing Branch, Office of Management & Budget, 725 17<sup>th</sup> Street NW, Room 9226,  
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House Committee on Financial Services, 2129 Rayburn House Office Building,  
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