



Issue Date May 28, 2004
Audit Case Number 2004-PH-1007

TO: Lynn Daniels, Director, Office of Community Planning and Development,
Pittsburgh Area Office, 3ED

for J. Phillip Schiff

FROM: Daniel G. Temme, Regional Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Review of the Community Development Block Grant (CDBG) Program for
the City of McKeesport
McKeesport, Pennsylvania

INTRODUCTION

In response to a request from the U.S. Department of Housing and Urban Development's (HUD's) Pittsburgh Office of Community Planning and Development, we completed a review of the Community Development Block Grant (CDBG) Program for the City of McKeesport. Specifically, our review concentrated on the City's oversight of the Home Improvement Loan Program by its sub-recipient, the McKeesport Housing Corporation, for Fiscal Years 2000 through 2002.

The primary objective of our review was to determine if the City of McKeesport established adequate management controls to ensure its sub-recipient administered its Home Improvement Loan Program in compliance with HUD regulations and requirements. More specifically, we wanted to determine if (1) the City adequately monitored its sub-recipient's use of the Program income generated under the Home Improvement Loan Program, and (2) the Program income received by the sub-recipient was disbursed in accordance with HUD regulations.

To achieve our objectives, we reviewed the appropriate Federal requirements, the City of McKeesport's Fiscal Year 2000 and 2001 Consolidated Action Plan and their Consolidated Annual Evaluation and Performance Report. We also reviewed the agreement between the City of McKeesport and the McKeesport Housing Corporation concerning the implementation of the CDBG Programs which related to homeowners and owners of residential rental properties. In addition, we reviewed the related accounting records of the sub-recipient including source documentation to determine the eligibility

of \$696,134 of CDBG Program income that was disbursed from 2000 through 2002. The disbursements included \$351,812 in payments to five rehabilitation contractors, \$179,398 to five consultants, and \$164,924 for indirect costs charged to the Program.

The audit covered the period January 2000 through December 2002. We performed the majority of our fieldwork at the City of McKeesport's main office located at 201 Lysle Boulevard, McKeesport, Pennsylvania and at the McKeesport Housing Corporation's office located at 502 Fifth Avenue, McKeesport, Pennsylvania. We conducted the audit in accordance with Generally Accepted Government Auditing Standards. We held an exit conference with the mayor of the City of McKeesport on April 16, 2004.

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 110 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.

We appreciate the courtesies and assistance extended by the personnel of the City of McKeesport, the McKeesport Housing Corporation and the local Pittsburgh Field Office during our review. Should you or your staff have any questions, please contact Ms. Christine Begola, Assistant Regional Inspector General for Audit, at (410) 962-2520.

SUMMARY

We found the City of McKeesport did not adequately monitor the performance of its sub-recipient, the McKeesport Housing Corporation, to ensure it administered its Home Improvement Loan Program in compliance with HUD requirements. Specifically, the City of McKeesport did not review quarterly status reports submitted by the McKeesport Housing Corporation to ensure Program income it generated through its Home Improvement Loan Program was used to fund eligible activities in accordance with HUD and OMB requirements. These problems occurred because the City of McKeesport did not have adequate policies and procedures in place to ensure that its sub-recipients were being monitored on a yearly basis, nor did they ensure that appropriate action was taken when performance standards were not met.

As a result of the City of McKeesport's failure to adequately monitor the McKeesport Housing Corporation, it did not identify a number of significant deficiencies in the sub-recipient's administration of its Home Improvement Loan Program. Specifically, the McKeesport Housing Corporation violated Federal procurement regulations and requirements when it procured consultants for accounting, legal, computer, financial audit and loan underwriting services; and rehabilitation contractors. We also found the sub-recipient did not establish a cost allocation plan to ensure indirect costs were equitably distributed to the Home Improvement Loan Program and other CDBG Programs. Because of these deficiencies, the McKeesport Housing Corporation spent \$694,573 of expenditures it could not support.

BACKGROUND

Title I of the Housing and Community Act of 1974 established the Community Development Block Grant (CDBG) Program, which provides annual grants on a formula basis to many different types of grantees through various programs including Entitlement Communities, State Administered CDBG, Section 108 Loan Guarantee Program, and HUD-administered Small Cities to name a few. The annual appropriation for CDBG is split between states and local jurisdictions called “entitlement communities”. The funds used under any of the CDBG Programs’ activities must meet one of the following national objectives for the Program: benefit low- and moderate-income persons, prevent or eliminate slums or blight, or meet community development needs.

Since 1985, the City of McKeesport has participated in the Entitlement Grant Program and the Section 108 Loan Guarantee Program. In order to accomplish the objectives of these Programs, the City has entered into sub-recipient agreements with the McKeesport Housing Corporation and other sub-recipients. Our review concentrates on the City of McKeesport and its relationship with the McKeesport Housing Corporation.

From 1985 to 1990, HUD provided the City of McKeesport over \$500,000 to establish a revolving loan fund. This fund was established for the purpose of carrying out specific CDBG activities, which in turn generate payment to the same fund to be used in carrying out similar activities in the future. One of the programs the City used the revolving loan fund for was the Home Improvement Loan Program (Loan Program.) The Home Improvement Loan Program is used to help finance loans for low-income homeowners to rehabilitate their home or obtain affordable housing. In addition to the Loan Program, a homeowner may use other financing sources including private financing to finance the rehabilitation of their homes. When a homeowner starts to pay back the principal and interest on the home improvement loan, it generates Program income. The Loan Program income is deposited into the revolving fund and then disbursed as new loans for other low-income homeowners. The City managed this Program until 1995, when it then turned the Loan Program over to the McKeesport Housing Corporation to manage. When the McKeesport Housing Corporation received the Loan Program, HUD worked with them to set up a similar revolving fund system to implement the Home Improvement Loan Program.

From Fiscal Year 2000 through 2002, the City of McKeesport received \$4,866,000 in CDBG funding from HUD to implement several programs including public improvement, housing, economic development, and for the administration fees associated with these and other programs. The City then used these funds as leverage to obtain matching funds from banks and private entities to continue their programs. In addition, the City provided approximately \$800,000 of entitlement and Program income for McKeesport Housing Corporation from 2000 to 2002. The City and the sub-recipient’s funding from 2000 to 2002 are shown below.

Block Grant Funding for 2000 through 2002

Program Year	City of McKeesport	McKeesport Housing Corporation			
		Home Improvement Loan Program Income ¹	Other CDBG Programs ²	HOME Program	Total CDBG and HOME Funds for McKeesport Housing Corporation
2000	\$1,599,000	\$312,285 ³	\$146,000	\$ 760,510	\$1,218,795
2001	\$1,653,000	\$234,113	\$ 49,200	\$ 298,964	\$ 582,277
2002	\$1,614,000	\$184,093 ⁴	\$ 87,035	\$ 308,257	\$ 579,385
Total	\$4,866,000	\$730,491	\$282,235	\$1,367,731	\$2,380,457

FINDING

The City Did Not Adequately Monitor the McKeesport Housing Corporation’s Home Improvement Loan Program

The City of McKeesport did not adequately monitor the performance of its sub-recipient, the McKeesport Housing Corporation, to ensure it administered its Home Improvement Loan Program in compliance with HUD’s Program regulations and requirements. Specifically, the City’s Community Development Department did not monitor the Program income that the Corporation deposited into and disbursed from its revolving loan fund to ensure Program income was disbursed in accordance with Federal regulations and guidelines. We found the City did not have adequate policies and procedures in place to ensure it properly monitored its sub-recipient, or that responsible City officials would take appropriate action when the Corporation did not meet its performance standards. As a result, the City failed to identify its sub-recipient was not spending CDBG funds in accordance with Federal regulations and guidelines. In total, its sub-recipient paid \$694,573 of expenses that were not properly supported.

Title 24 Code of Federal Regulations (CFR) 570.501 requires that a recipient of CDBG funds be responsible for ensuring the use of those funds is in accordance with all Program requirements. The City’s use of the McKeesport Housing Corporation as a sub-recipient does not relieve them from this oversight responsibility.

¹ HILP Program income is considered CDBG Program income.

² Other CDBG programs include: Community Development (Entitlement Program), McKeesport Aging Program, and Paint and Sidewalk Program. None of these programs were audited during our review.

³ Includes \$125,687 in the funds from the prior fiscal year.

⁴ Excludes \$11,817 in the fund at the end of the fiscal year.

Monitoring Efforts by the City Are Not Adequate

During our review, we reviewed the City's monitoring files for the contract years 2000 through 2002. We found the City used a checklist to perform a cursory monitoring review of the McKeesport Housing Corporation in 2001. However, this limited review did not include a review of the sub-recipient's Program income. The City also did not monitor the sub-recipient's Program income in 2000 and 2002. When we asked why the City was not conducting reviews of the sub-recipient, the City official stated that they were working on more immediate issues concerning the City and were not aware that they were required to monitor the same recipients every year. They also attributed the lack of monitoring in 2002 to the fact that HUD Program staff had conducted a monitoring review of the City's sub-recipient, so there was no need for the City to also complete one.

We also reviewed the City's monitoring files to determine whether City officials ensured the sub-recipient submitted the required performance reports. The McKeesport Housing Corporation was required to submit Quarterly Demographic Reports, which summarize all the loans issued by the sub-recipient. Although the Corporation submitted a report on a quarterly basis summarizing the funding sources for applicants financing a new home or rehabilitating existing homes, the monitoring file contained no evidence that the City actually reviewed the submitted reports. These deficiencies occurred because the City did not establish and implement written policies and procedures to ensure City officials adequately monitor its sub-recipient's reported activities and take appropriate action when performance standards are not met.

In addition, we noted the sub-recipient agreements established between the City and the McKeesport Housing Corporation were not adequate. The agreements did not provide for a description of services to be performed, a work schedule or a budget. The agreements also did not clearly establish how the Program income is to be treated. Title 24 CFR 570.503 establishes requirements for a written agreement to include a statement of work, which should include a defined scope of services and a performance schedule. It also requires an agreement to describe how Program incomes should be handled.

HUD Also Expressed Monitoring Concerns

HUD's local Program office conducted a monitoring review of the City in May 2002 and expressed concern that costs paid out of the revolving fund by the McKeesport Housing Corporation may not have been appropriate, specifically citing that the McKeesport Housing Corporation used its revolving fund to renew accounting and legal contracts without following Federal procurement rules. Subsequently, HUD could not determine how the revolving funds were used. HUD gave the McKeesport Housing Corporation 90 days to initiate and complete a new procurement process for these services or to repay HUD the related costs with non-Federal funds. To date, HUD has not taken any action.

City's Sub-recipient Awarded Contracts Contrary to Its Grant Agreement and HUD Regulations

We found the McKeesport Housing Corporation did not follow Federal procurement regulations when awarding consultant and rehabilitation contracts. The Corporation did not prepare a required cost or price analysis prior to awarding the contracts, awarded contracts without competition, and did not issue written contracts on these awards. In addition, the McKeesport Housing Corporation did not prepare a cost allocation plan to properly allocate indirect costs to the CDBG Program. These deficiencies occurred because the Corporation did not follow the applicable provisions of its sub-recipient agreement, and HUD statutes and regulations. As a result, the McKeesport Housing Corporation used Program income to pay \$694,573 for expenditures that were not supported.

Required Cost Estimates and Cost or Price Analysis Were Not Performed for All Procurements

The McKeesport Housing Corporation did not perform the required cost or price analysis for all procurements from 2000 through 2002. This included contracts for accounting, computer, legal, loan underwriting, financial audit services and rehabilitation construction. Title 24 CFR 84.45 requires the sub-recipient to perform some form of cost or price analysis in connection with every procurement action. A sub-recipient is also responsible for preparing accurate cost estimates prior to receiving bids or proposals to ensure contracts prices are fair and reasonable. Without the required cost estimates, the sub-recipient has no assurances that it obtained the best available services at the most advantageous prices for its procurement.

When we presented this finding to the McKeesport Housing Corporation, they agreed that cost or price analyses were not performed. They also indicated they had no knowledge of the requirements to complete a cost or price analysis.

Procurements Completed Without Competition

Contrary to procurement requirements, McKeesport Housing Corporation did not competitively award contracts it obtained from 2000 through 2002. This included contracts it awarded to vendors to complete rehabilitation construction work and consulting contracts for various administrative services. Rather than use the competitive bid process and properly advertise the bid information, the McKeesport Housing Corporation would pass the bid information onto prospective bidders by word of mouth via City officials or other vendors. By conducting the bidding process in this way, the McKeesport Housing Corporation was directly violating the City's procurement policy it had stated it was following. In addition they violated Federal regulations. Title 24 CFR 84.43 states all procurement actions are to be performed to provide for free and open competition.

Prospective Bids Were Not Considered During the Procurement Process

During our review of the 2000 through 2002 Home Improvement Loan Program rehabilitation construction files, we found the McKeesport Housing Corporation did not give fair consideration to all prospective bids at the time bids were selected. For example, prior to obtaining a contractor, the McKeesport Housing Corporation develops a specification for a bid based on a cost estimate and a visitation to the property. Based upon that estimate the two bidders that come within the 10% range of the overall cost estimate would be selected and provided to the homeowner. The homeowner would then select the contractor they would want to complete the work. However, the McKeesport Housing Corporation did not include all the bids it had received in their overall tabulation. A review of the procurement files showed that the McKeesport Housing Corporation did not include 4 of 40 bids or (10%) in the tabulation process. As a result, homeowners did not have access to bids that were within the 10% range for the cost estimates. When we discussed this issue with the sub-recipient, they agreed that the bids we noted should have been included in the tabulation and they did not have an explanation as to why they were not.

We also noted that the McKeesport Housing Corporation continually used the same rehabilitation construction contractors year after year. For example, for the time period 2000 through 2002, the Corporation contracted out with five construction contractors, three of which received continual work each of the three years, while the other two received work in only one of the years reviewed. Upon further review of these contractor's files, we could not locate any documentation reflecting the basis for the cost estimates for these contracts, which is a violation of 24 CFR 84.46, which requires procurement records and files to include a basis for the award and cost or price. Due to the deficiencies in the McKeesport Housing Corporation's procurement of these construction contracts, we consider \$350,251 of these contracts issued from 2000 through 2002 to be expenditures that were not supported.

Consultants Obtained Without Formal Contracts

In addition to the issues we noted during our review of the construction contractors, we found the McKeesport Housing Corporation contracted with five consultants to provide various types of services. For the time period 2000 through 2002, the McKeesport Housing Corporation obtained the services for all five of these consultants without ever issuing a formal written contract. Instead, both the consultant and the Corporation relied solely on their verbal agreements with each other for \$179,398 in services. This is a direct violation of Federal requirements which state, under 24 CFR 84.48, that sub-recipients are to maintain a sound and complete agreement. Further, a system must be maintained to ensure contractor compliance with terms, conditions and specifications. Since the McKeesport Housing Corporation did not have a written agreement with these five entities and violated the Federal procurement procedures, we consider \$179,398 unsupported.

City's Sub-recipient Did Not Properly Allocate Indirect Costs Between Programs

The McKeesport Housing Corporation also allocated certain costs to the Home Improvement Loan Program that included salaries, travel, training, telephone, rent, insurance, and consumable supplies when they should have been allocated between the various Programs. OMB Circular A-122 Attachment A, provides guidance on the basic considerations for the allocation of indirect costs. The guidance provides that the sub-recipient must support a cost allocation that takes into account all activities of the organization. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates. A non-profit organization that does not have an approved cost allocation plan must submit an initial cost allocation plan within three months of receiving the award.

When we requested a copy of the cost allocation plan, the McKeesport Housing Corporation official said they did not submit an allocation plan to the cognizant Federal agency. Instead we found the McKeesport Housing Corporation spent \$164,924 on indirect costs from 2000 through 2002 and charged the entire amount to the Home Improvement Loan Program. Since the McKeesport Housing Corporation also participates in the HOME Program and other CDBG programs, these indirect costs should have been allocated between these other programs and the CDBG revolving fund. Instead, it placed a tremendous burden on the revolving fund, which resulted in a 50% increase in indirect costs paid out of the revolving fund from 2000 to 2002. As the chart below shows, the indirect costs that were charged against the revolving fund have been steadily rising.

**Indirect Costs for MHC
2000 through 2002**

Calendar Year	Indirect Costs Charged to HILP
2000	\$ 15,528
2001	\$ 51,584
2002	\$ 97,812
Total	\$ 164,924

Since the sub-recipient's Home Improvement Loan Program accounted for only \$730,491, or 31%, of the \$2,380,457 in CDBG funds they received during the period, it was not reasonable to charge the Home Improvement Loan Program the entire indirect costs. Thus, we consider the entire amount unsupported.

AUDITEE COMMENTS

The City's response to our audit memorandum is included in Appendix B. Overall, the City agreed with our assessment and is prepared to work with HUD's Community Planning and Development staff to implement our recommendations.

RECOMMENDATIONS

We recommend the Director of Pittsburgh's Office of Community Development require the City of McKeesport to:

- 1A. Establish an adequate agreement with their sub-recipients that would be in line with HUD guidelines.
- 1B. Establish and implement a comprehensive monitoring system of their sub-recipients that would include:
 - a. Documenting and implementing written policies and procedures for oversight of their sub-recipients before the next funding cycle. The policies should:
 - i. Be based upon HUD guidance.
 - ii. Include the actions that are to be taken when a sub-recipient fails to meet its performance standards.
 - iii. Include specific guidance on validating reported progress through on-site reviews.
 - b. Reviewing Program income to ensure that the sub-recipient is disbursing Program income in accordance with HUD guidelines.
- 1C. Provide proper support documentation for \$179,398 in consultant contract costs that the Corporation charged to the Loan Program. If these funds cannot be supported they should be paid back to HUD with non-Federal funds.
- 1D. Provide proper support documentation for \$350,251 in rehabilitation contract costs the Corporation charged to the Loan Program. If these funds cannot be supported they should be paid back to HUD with non-Federal funds.
- 1E. Provide proper support documentation for \$164,924 in indirect costs the Corporation charged to the Loan Program. If these funds cannot be supported they should be paid back to HUD with non-Federal funds.
- 1F. Develop and implement adequate procurement policies and procedures. Specifically, the procurement polices and procedures should include:

- a. Procedures to ensure adequate controls are implemented in accordance with HUD rules and regulations.
 - b. Procedures for preparing cost estimates prior to receiving bids or proposals.
 - c. Procedures for performing cost or price analysis for every procurement action.
- 1G. Develop and implement a cost allocation system that would provide for proper allocation of the indirect costs between the various programs.

MANAGEMENT CONTROLS

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to the CDBG Program to determine our audit procedures, not to provide assurance on the controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Policies and procedures over reporting of activities and associated costs, and
- Documentation to support activity and cost eligibility.

We assessed all of the relevant control categories identified above, to the extent they impacted our audit objective.

Significant Weaknesses

A significant weakness exists if management controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review we believe the following items are significant weaknesses:

- The City did not have a sub-recipient monitoring system to ensure that Program income expended from a revolving fund was for eligible activities, properly supported by appropriate source documentation, and allocable as a grant expenditure.
- The sub-recipient did not have a system in place to ensure proper procurement and cost allocation processes were implemented.

FOLLOW-UP ON PRIOR AUDITS

This is the first audit of the City of McKeesport's Community Development Block Grant Program by HUD's Office of Inspector General.

SCHEDULE OF QUESTIONED COSTS

Recommendation Number	Ineligible Costs 1/	Unsupported Costs 2/
1C		\$179,398
1D		\$350,251
1E		\$164,924

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-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 charged to a HUD-financed or HUD-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 costs. 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

OFFICE OF
THE MAYOR

JAMES R. BREWSTER
MAYOR
"McKeesport - Bringing it Back"



BY FAX:

M E M O R A N D U M

TO: DANIEL G. TEMME, REGIONAL GENERAL INSPECTOR FOR AUDIT

ATTN: CHRISTINE BEGOLA, ASSISTANT REGIONAL GENERAL INSPECTOR FOR AUDIT

FROM: JAMES R. BREWSTER, MAYOR *JRB.*

RE: REVIEW OF CDBG PROGRAM - CITY OF MCKEESPORT, PENNSYLVANIA

DATE: MAY 13, 2004

I have reviewed your correspondence to City Administrator Dennis Pittman dated April 21, 2004 (copy enclosed). Solicitor J. Jason Elash and I concur that you have captured those discussion items presented in the meeting of April 16, 2004 with Chaundra Dey, OIG Auditor, Elash, Pittman and myself. Once the final document is prepared, the City of McKeesport would appreciate a copy so that we may work expeditiously with Lynn Daniels, Director of CPD Division, Pittsburgh Area Office, 3ED and members of his staff to resolve and/or implement the recommendations presented.

On behalf of the City of McKeesport, I would like to thank you and other members of the Regional Inspector General for Audit for their cooperation during this review.

cc: C. Dey, OIG Auditor

P. S. Hard Copy to Follow in the Mail

