



Issue Date	December 8, 1998
Audit Case Number	99-KC-244-1001

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

FROM: Jose R. Aguirre, District Inspector General for Audit, 7AGA

SUBJECT: Community Development Block Grant Program
Department of Housing and Community Development
City of Kansas City, Missouri

We have completed our limited review of the Community Development Block Grant (CDBG) Program administered by the City of Kansas City, Missouri (City). We performed the review to evaluate City monitoring of subrecipient performance and to evaluate selected subrecipients' compliance with rules and regulations. This report contains one finding and recommends the City improve monitoring to ensure subrecipients comply with Federal requirements. We provided the auditee a copy of this report.

Within 60 days please furnish us, for each recommendation in this report, a status report on: (1) corrective action taken; (2) proposed corrective action and the date to be completed; or (3) why action is not necessary. Also, please provide us copies of any correspondence or directives issued because of the audit.

If you have any questions, please call me or Ron Hosking, Assistant District Inspector General for Audit at (913) 551-5870.

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Executive Summary

We performed a limited review of the City's CDBG program. The review was not a comprehensive evaluation of all the activities of the City's Department of Housing and Community Development. Rather, the review concentrated on monitoring of subrecipients and the related activities of some selected subrecipients. Our objectives were to determine whether the City had adequate controls to ensure that subrecipients carried out activities prescribed in their contract and complied with applicable Federal requirements.

We found the City made some improvements in its monitoring of subrecipients through changes made as a result of HUD's monitoring review last year. Also, the City was in the process of establishing a new Monitoring Division to further improve its monitoring efforts by focusing on evaluating performance and compliance of subrecipients.

However, our review showed the City still needs to make further improvements.

Subrecipient Monitoring Improvements Needed

The City did not adequately oversee the performance of the Kansas City Downtown Minority Development Corporation (Corporation) and did not hold the board responsible for effecting collections of monies loaned. As a result, businesses receiving loans seldom made the required payments; loan repayments were not available to make new loans; and the Corporation is currently due about \$13 million. We recommended the Director, Office of Community Planning and Development, verify that the City implements monitoring procedures and develops, implements and maintains a loan collection program.

The City did not ensure that the East Meyer Community Development Corporation complied with contract award requirements because it did not properly monitor corporation activities. East Meyer did not have a written contract for a major sanitary sewer installation. In addition, it did not properly monitor the contractor's work. As a result, East Meyer and the contractor are now in dispute over the propriety of a \$157,000 change order. We recommended that the Director also verify the City strengthens its monitoring and provide subrecipients technical assistance on required Federal contracting requirements.

The City executed contracts with community development corporations to perform housing activities and included performance standards that were not met. The City needs to consider past performance, evaluate reasons for not

meeting the performance goals, and adjust subsequent contracts to more realistic goals.

We performed our review from March through July 1998. We discussed the draft finding with City officials during an August 8, 1998 exit conference. The City provided written comments on September 1, 1998 which generally agreed with the finding and recommendations. The comments are included in their entirety as Appendix A.

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Introduction

The CDBG Program, established by Title I of the Housing and Community Development Act of 1974, provides grants to units of general local government for development of viable urban communities. CDBG program objectives are to provide decent housing, suitable living environments and to expand economic opportunities, primarily for low and moderate income persons.

The City's Department of Housing and Community Development administers its CDBG program. Four divisions report to the Director: administration, planning, small business, and housing. Department of Housing and Community Development offices and related records are located in City Hall.

The Department of Housing and Community Development contracts with subrecipients to perform most CDBG activities. During the most recent program year, the City entered into 43 contracts with subrecipient organizations. Independent public accountants perform annual audits of the subrecipients.

In 1997, local HUD office monitoring identified weaknesses in the City's subrecipient monitoring. The City has since modified its monitoring program.

Audit Objectives

Our objectives were to determine whether:

- The City had adequate controls to ensure subrecipient compliance with HUD regulations.
- Subrecipients carried out activities as shown in their contracts economically, efficiently and effectively.
- Subrecipients complied with Federal program requirements, laws and regulations.

Audit Scope and Methodology

We performed our on-site work from March 1998 through July 1998. We interviewed HUD and City staff. We also reviewed 43 contracts, valued at \$11.1 million, awarded to subrecipients during program year 23 (April 1, 1997 through March 31, 1998).

Based on reviews of contract files, we selected five subrecipients for further study: Old Northeast Community Development Corporation, the Community Development Corporation of Kansas City, East Meyer Community Development Corporation, Kansas City Downtown Minority Development Corporation, and the Maintenance Reserve Corporation. While on-site at the community

development corporations, we reviewed documentation supporting grant expenditures and activities for compliance with Federal regulations and the City contracts. We reviewed and evaluated loan collection policies and procedures of the Kansas City Downtown Minority Development Corporation and evaluated the need for large reserves at the Maintenance Reserve Corporation.

Our review generally covered the period from April 1, 1997 through March 31, 1998 and was conducted in accordance with generally accepted government auditing standards.

We provided a copy of the draft finding to the HUD program staff and the City on August 17, 1998. The City provided written comments on September 1, 1998. Their comments generally agreed with our finding and are included in their entirety as Appendix A.

Finding and Recommendations

City Needs to Strengthen Oversight Of Subrecipients

The City did not adequately oversee the performance of its subrecipients to ensure subrecipients complied with their contractual requirements or with applicable regulations. In 24CFR570.501 it states that the grant recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements, even if it uses subrecipients to administer the funds. The City is also responsible for determining the adequacy of performance under subrecipient agreements and for taking actions when performance problems arise.

As a result, subrecipients have not spent CDBG funds as effectively and efficiently as desired. More specifically, we found that:

- The Kansas City Downtown Minority Development Corporation did not pursue collections on loans made to businesses.
- East Meyer Community Development Corporation did not follow required contracting and contract monitoring procedures.
- The City contracted with community development corporations but did not adjust subsequent contracts to more realistic goals.

K.C. Downtown Minority Development Corporation

The City did not adequately oversee the performance of the Kansas City Downtown Minority Development Corporation (Corporation) and did not hold the governing board responsible for collecting moneys loaned. As a result, businesses receiving loans seldom made the required payments and loan repayments were not available to make new loans. The corporation was owed about \$13 million from these loans.

Corporation Provided Three Types of Assistance

The Corporation has been involved in three types of assistance to businesses. Initially, the Corporation administered Urban Development Action Grants to businesses. Some of these grants generated loan repayments to the Corporation. The Corporation used loan repayments as well as CDBG funds to make direct loans to businesses. The last direct loan was made in 1996. After that, the Corporation purchased certificates of deposit and pledged the certificates as security to banks making business loans. The Corporation recently started a new program

Businesses Have Not Made Loan Payments

with \$1 million in State of Missouri economic development grant funds and used the funds to purchase certificates of deposits to guarantee new business loans.

Since July 1993, businesses have paid only about \$150,000 on the \$13 million in outstanding loans. The following table shows the types of loan assistance and the number of borrowers making payments since July 1993.

Source of Funds	Number of Loans Made	Loans With Payments Since July, 1993
UDAG	5	1
CDBG	2	0
UDAG Repayments	21	8

The Corporation has not pursued collections on delinquent loans. Available documentation at the City and the Corporation’s attorney showed no collection efforts since about 1994. The prior efforts were letters from the attorney to delinquent borrowers. Many loans are likely uncollectible because the businesses have closed. However, operating businesses that have not made payments in years, and the amounts owed, include a shopping center (\$2 million), national charity (\$355,000), distributorship (\$584,000) and mortuary (\$85,000).

A Corporation official told us the new board of directors is aware of the problem and intends to pursue collections.

The City should develop and implement a monitoring plan that would help ensure the Corporation takes appropriate efforts to collect on the loans.

East Meyer Community Development Corporation

The City did not ensure that East Meyer Community Development Corporation complied with contract award requirements because it did not properly monitor corporation activities. East Meyer did not have a written contract for a major sanitary sewer installation. In addition, it did not properly monitor the contractor’s work. As a result, East Meyer and the contractor are now in dispute over the propriety of a \$157,000 change order.

No Formal Contract

Federal regulations (24CFR84.84) require a contract which defines a sound and complete agreement and requires that a system be maintained to ensure contractor compliance with contract terms, conditions and specifications.

East Meyer solicited bids for the sewer project by telephone, but did not document the firms contacted. Two firms responded; the low bid, \$63,709, stated “All rock excavation will be extra.” East Meyer awarded the job based on this bid but did not prepare a written contract.

Scope of Needed Work
Not Known

The scope of work was based on plans prepared by an engineering firm. These plans did not anticipate any rock excavation. After contractor selection, East Meyer hired a geological engineering firm to conduct site tests and determine rock content. The tests showed a moderate amount of rock would be encountered during excavation. Despite these results, East Meyer did not prepare a written contract addressing the rock problem.

Weak Contract
Monitoring

After construction started, the contractor notified East Meyer it encountered rock during excavation. When East Meyer’s engineering firm first visited the job site, much of the work was complete and most of the trench had been back filled. Later, the contractor submitted a \$157,081 change order for rock excavation.

The engineers believed far more rock was encountered than anticipated by their geological testing. However, they did not agree with the contractor’s method of calculating the change order amount. The absence of contract terms specifying an acceptable method for calculating change order amounts has made it difficult to resolve the dispute.

The City official responsible for monitoring East Meyer reviews their contracting efforts once a year but did not review the sanitary sewer contract.

The City needs to improve technical assistance and monitoring to ensure subrecipients become aware of and implement applicable procurement regulations.

Completion of Contract
Activities

The City executed contracts with community development corporations to perform housing activities and included performance goals that were not met. When executing

subsequent contracts, the City did not take into consideration the reasons for unmet goals and did not adjust subsequent contracts to be more realistic. The City needs to consider past performance when renewing contracts with community development corporations.

Each year the City enters into a contract with each community development corporation to pay program administrative costs. These contracts contain services to be performed as well as performance standards.

We compared new single family homes built or rehabilitated during the program year ended May 31, 1998 with performance standards in the contracts at three community development corporations: Old Northeast, East Meyer and the Community Development Corporation of Kansas City. Progress reports submitted by these corporations showed none of them would complete the number of homes in their contracts. For example, the Community Development Corporation of Kansas City was to complete and sell eight homes during the recently completed contract period. The Corporation had five homes under construction but had not sold any during the period.



Causes of Lack of Performance

Community Development Corporation staff attributed shortfalls to the time it takes to get construction financing approved, staff turnover, contractors not completing work timely, and lack of citizen interest. City monitoring reports disclosed this problem and recognized reasons for not achieving contract goals. However, the City did not consider past performance or current construction impediments when developing goals for subsequent periods.

We believe the City should evaluate the justifications for goals not met and adjust subsequent contracts to more realistic goals.

Auditee Comments

The City agreed with our recommendation that they need better collection efforts at the Downtown Minority Development Corporation. Also, the City said procedures have been implemented to provide additional technical contracting assistance and oversight to subrecipients.

However, the City believes that in reviewing annual performance and awarding subsequent contracts, it does review

the performance of each organization and makes adjustments accordingly.

OIG Evaluation of
Auditee Comments

The City needs to improve annual performance reviews and make appropriate adjustments to subsequent contracts. For example, during Program Year 22, the Community Development Corporation of Kansas City was required to begin construction of seven single family homes. The Corporation started construction on two homes. In spite of this performance, their Program Year 23 contract was increased, calling for the construction and sale of eight single family homes.

Recommendations

We recommend that you:

- 1A. Verify City implementation of monitoring procedures that will help ensure the Kansas City Downtown Minority Development Corporation develops, implements and maintains a loan collection program. This program should provide for writing off loans determined to be uncollectible.
- 1B. Verify the City has strengthened its monitoring procedures and provided technical assistance to subrecipients on required Federal contracting requirements.
- 1C. Require that the City: consider subrecipient performance when awarding new contracts, evaluate reasons for not meeting performance goals, and, if warranted, adjust subsequent contracts to more realistic goals.

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Management Controls

In planning and performing our audit, we considered the City's management controls in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure 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 the following management controls were relevant to our audit objectives:

- Controls over compliance with laws and regulations .
- Controls over safeguarding resources.
- Controls over subrecipient program operations.

We assessed all of the relevant controls identified above.

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 City's monitoring of subrecipients is a significant control weakness (see Finding).

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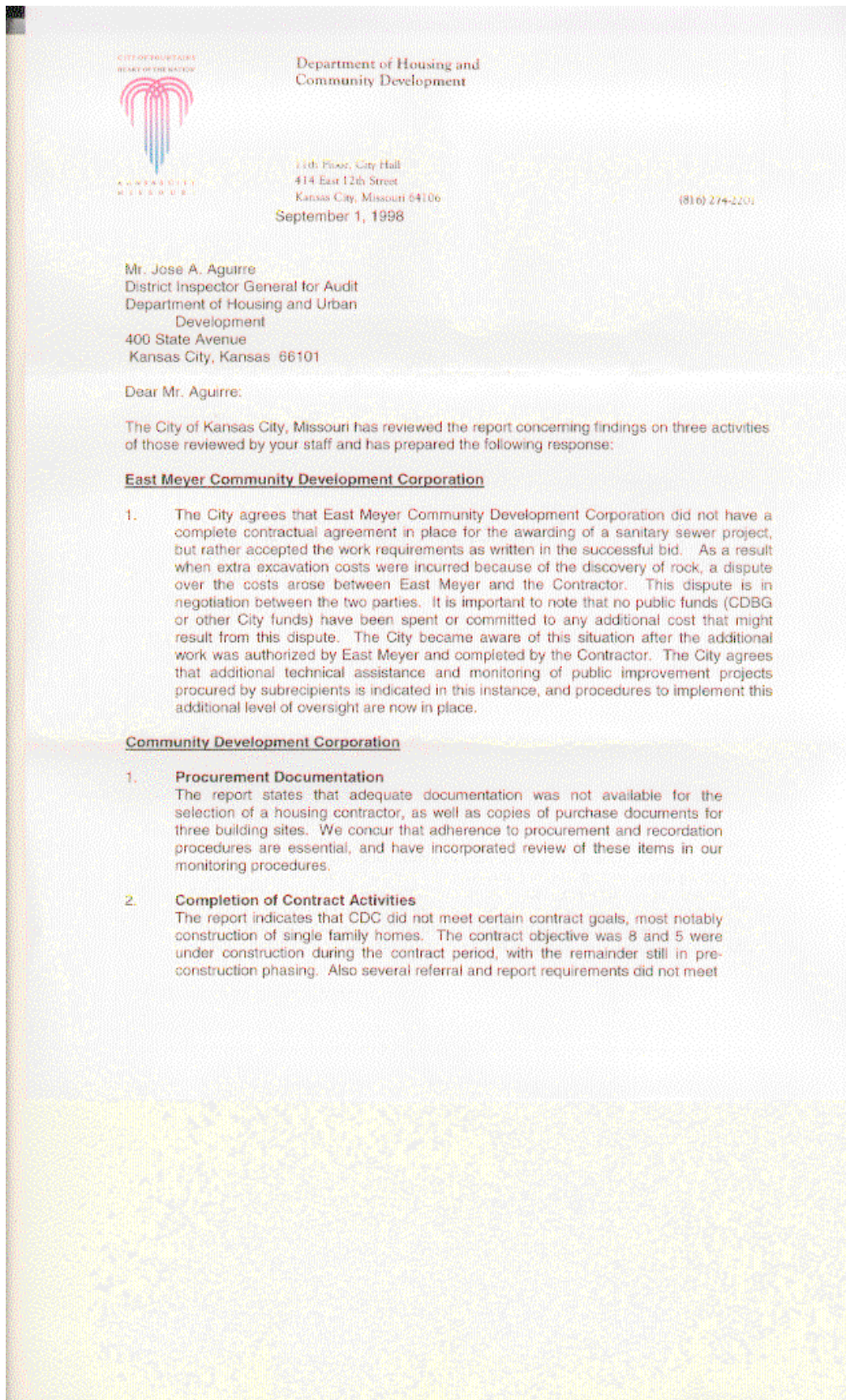
Follow Up On Prior Audits

The most recent financial audit covering the City's CDBG Program was for the year ended April 30, 1997. That report contained eight findings. Only one finding, dealing with controls over receipt of subrecipient audit reports, pertained to our audit objectives. The City has since implemented procedures to verify receipt of subrecipient audit reports.

The most recent OIG audit report was issued in February 1991. That review examined City and subrecipient handling of CDBG program income. The report identified significant problems with the City's handling of program income. Since our current audit objectives did not address program income, we did not follow up on the deficiencies cited in the 1991 audit.

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Auditee Comments



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the stated objectives. The report also recognized that CDC staff turnover contributed to these conditions, and that the monitoring reports maintained by the City documented these conditions. In reviewing annual performance and awarding subsequent contracts, the City does review the performance of each organization and make adjustments accordingly, which can affect cost allocation and/or performance objectives.

3. **Cost Allocation**

The report points out that the Community Development Corporation does not have an indirect cost allocation system, but the review believed that the Corporation incurred sufficient administrative costs to support the amount of CDBG funds reimbursed by the City. We have instructed CDC to add the additional breakdown of employee's time spent to the payroll records to document this record.

1. **DOWNTOWN MINORITY DEVELOPMENT CORPORATION**

While we concur with the basic recommendation that the DMDC develop and implement a loan collection program and believe that in fact, this is being done by the current Board of Directors, the overall record of loans and businesses assisted should be evaluated in the context of the organization's established purpose. DMDC was formed in 1978, primarily as a lending and underwriting vehicle to leverage private funds in conjunction with the federal Urban Development Action Grant (UDAG) program to create business and employment opportunities for low income and minority persons in Kansas City, with emphasis upon the Central Business District and vicinity.

As the City obtained UDAG funds from the Department of Housing and Urban Development, it utilized the DMDC as the public lender of last resort to fill the "UDAG gap" in conjunction with private funds to assist major development projects, including a downtown hotel (Allis Plaza/Marriott), and a multi-phased mixed income housing development in the downtown area (Quality Hill - Phases I and II). UDAG funds were utilized to fund the "non-economic" portion of development projects, which would not otherwise have been feasible. While return of UDAG loans was a secondary objective, in order that revolved funds could assist other businesses, the primary objective was to stimulate major development and employment within the downtown CBD loop and environs.

Three active UDAG loans (Allis Plaza/Marriott, Rivergate, and Quality Hill) are current based upon the loan terms. Two of these are performance based keyed to net return on income. While several of the other projects were not financially successful for the individual developer, and subsequently were taken back by the first position lender, each project has made a significant contribution to downtown employment, tax base, and environment. More than \$150 million of private funds were leveraged, with over 850 jobs created and 240 housing units constructed as

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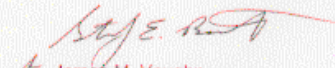
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a result of these UDAG loans. In several cases involving foreclosure, the City, although not in a first position, has received funds as settlement, which have been reprogrammed for small business lending by DMDC.

It should be noted that consistent with the original charter of DMDC, it has provided loans to minority business ventures with UDAG loan repayments, independent from the City. Besides the UDAG projects, the sole contractual relationship between the City and DMDC up to 1997 involved annual audits of the Corporation. Independent audits were conducted annually as part of the City's annual audit program. Since 1997, the City has a formal agreement with DMDC for implementation of the State's Urban Enterprise Loan Program, which does not involve federal funds. Prior to administering the UEL funds, a new Board of Directors were appointed to DMDC, who have retained the service of First Business Bank to provide loan underwriting for small business loans. The new board has also been in discussions with professional collection agencies to pursue the collection of delinquent and/or defaulted loans.

We appreciate having the response included in your final report.

Sincerely,


James M. Vaughn
Director

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Director, Housing and Community Development Issue Area
Attention: Judy England-Joseph
U. S. GAO
441 G Street, NW - Room 2474
Washington, D. C. 20548

Director, HUD Enforcement Center
1240 Maryland Ave., Suite 200
Washington, D.C. 20024

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Department of Housing and Community Development
414 East 12th Street
Kansas City, Missouri 64106