
AUDIT REPORT



HOUSING AUTHORITY OF BALTIMORE CITY

HOPE VI PROGRAM

2003-PH-1003

SEPTEMBER 4, 2003

OFFICE OF AUDIT, MID-ATLANTIC
PHILADELPHIA, PENNSYLVANIA



Issue Date	September 4, 2003
Audit Case Number	2003-PH-1003

TO: Milan M. Ozdinec, Deputy Assistant Secretary, Office of Public Housing Investments, PI

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

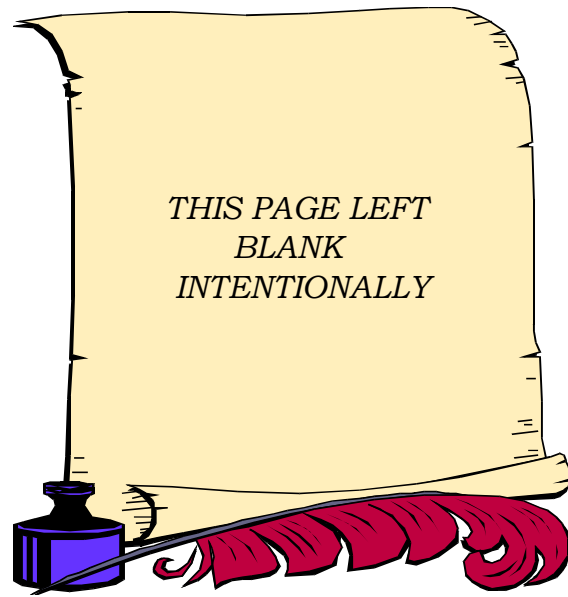
SUBJECT: Housing Authority of Baltimore City
HOPE VI Program
Baltimore, Maryland

We completed an audit of the Housing Authority of Baltimore City's (Authority) Homeownership and Opportunity for People Everywhere (HOPE) VI Program. The purpose of the audit was to determine whether the Authority implemented its HOPE VI Grants effectively, efficiently, and economically and in accordance with the Grant Agreements and applicable rules and Regulations.

We found the Authority did not operate its HOPE VI Program in an effective, efficient, and economical manner or in accordance with applicable requirements. The Authority needs to make improvements in the areas of procurement and contract administration, financial management, and Community and Supportive Services Program administration. The report contains three findings and applicable recommendations to improve the effectiveness of the Authority's operations.

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 120 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.

Should you or your staff have any questions, please contact J. Phillip Griffin, Assistant Regional Inspector General for Audit, at (215) 656-3401, extension 3490.



Executive Summary

We completed an audit of the Housing Authority of Baltimore City's (Authority's) Homeownership and Opportunity for People Everywhere (HOPE) VI Program. The objectives of the audit were to determine if the Authority implemented its HOPE VI Grants effectively, efficiently, economically and in accordance with the Grant Agreements and applicable rules and Regulations.



The Authority Did Not Implement Grants Properly

We found the Authority did not implement its HOPE VI Grants effectively, efficiently, and economically and in accordance with the Grant Agreements and applicable rules and Regulations. Specifically, the Authority's: procurement and contract administration practices violated Regulations; managers did not maintain accurate financial records as required; and administration of the Community and Supportive Services Program was not effective. This occurred primarily because a prior Executive Director did not establish the proper internal control environment under which the Program was administered. An adequate internal control environment is one in which good business practices prevail and improper practices are less likely to occur and, if they do occur, are more likely to be detected and corrected. As a result, many deficiencies in the Authority's operations were noted, among the most notable being the Authority spent \$28,532,646 above the Total Development Cost (TDC) limits on two developments. The Authority's former Executive Director provided misleading information to HUD and did not fully disclose other information related to the development activities. Because HUD relied on the former Executive Director's assertions, it did not have all the facts and granted waivers to exceed development standards and award contracts. The primary issue areas are summarized below and detailed in the Findings Section of this report.

Procurement And Contract Administration Had Problems

We observed fundamental weaknesses in the Authority's execution of the HOPE VI procurement and contract administration process. Specifically, the Authority did not document key procurement actions, initiated and completed a number of improper contracting actions, and did not adequately administer its HOPE VI contracts. These deficiencies occurred because the former Executive Director did not establish an adequate internal control environment under which the Program was administered. The former Executive Director and Authority staff often ignored the applicable HOPE VI requirements that resulted in

mismanagement of the HOPE VI Program. As a result, the Authority: exceeded HUD development costs by \$19,227,051 for one development and by \$9,305,595 for another development.

Financial Management
Was Weak

The Authority's financial management of the HOPE VI Program was weak and managers did not maintain financial records in accordance with Federal requirements. Specifically, the Authority: did not follow HUD requirements when drawing funds from the HUD Line of Credit Control System (LOCCS); did not maintain accurate and complete accounting records; and displayed various other deficient financial management practices. These deficiencies occurred because Authority managers did not provide adequate supervision and oversight and did not establish proper procedures to ensure the Authority was in full compliance with the Grant Agreements and other applicable requirements. As a result, the Authority's financial management produced many deficiencies, including: funds of over \$31.7 million drawn from LOCCS could not be readily supported; accounting records contained errors of more than \$37.2 million and disagreed with HUD's records by approximately \$27.9 million; development costs authorized by HUD were exceeded by over \$2 million for one development and were on track to be exceeded for a second development; and duplicate funding of \$916,995 was inappropriately retained. Thus, Authority personnel were unable to effectively manage funds and their ability to make effective management decisions was impaired. Also, the deficiencies impaired HUD's ability to provide effective oversight to the Authority in administering its Program.

Problems Were Noted
With The Community
And Supportive Services
Program

Finally, we noted the Authority did not effectively administer its Community and Supportive Services (CSS) Program according to the Grant Agreements and Federal Regulations. The Authority did not provide sufficient services to former residents of the revitalized developments and did not adequately monitor the CSS Program. Once again, these problems developed because the Authority's management did not establish the necessary procedures to properly administer and monitor the CSS component of its HOPE VI Program. As a result, former residents of the HOPE VI sites did not receive services that HUD intended

and the Authority did not know if its HOPE VI goals and objectives were achieved.

Current Executive Director Took Actions To Correct Problems

During the audit, we noted the current Executive Director took a number of actions to improve the management of the HOPE VI Program. For example, the Executive Director disbanded the Hope VI Office in March 2001 and transferred those duties to the Development Office. In January 2002, the Executive Director arranged for HUD to provide a senior manager to perform as a full-time Development Advisor. In October 2002, the Executive Director hired an Associate Deputy Director for Planning and Development and staffed the Development Office with two senior Real Estate Development Managers. The Executive Director also hired a Chief Financial Officer in order to improve the Authority's financial management operations. In December 2002, the new Chief Financial Officer: created and filled the position of Director of Procurement and Contracts and centralized all procurement activities and files under this position; automated the Authority's purchasing system to ensure accurate tracking of procurements and contracts; completed an internal assessment of the Authority's procurement and contract function; revised and streamlined the Authority's Procurement Policy in response to the assessment; and implemented standardized procurement documents and checklists. The Executive Director also hired: an Inspector General to fill a vacant position and the Inspector General now reports to the Board; and, a Deputy Executive Director to assist in managing the Authority. In addition, the Authority hired an auditor to review its HOPE VI Program. These actions are significant and positive steps in helping turn the HOPE VI Program around.

Recommendations

We recommended that administrative action be taken against the former Executive Director because of the deficiencies noted during our audit. Further, we made additional recommendations to improve the Authority's administration of its HOPE VI Program and to return funds to HUD. Authority officials generally agreed to make improvements in the administration of the HOPE VI Program but disagreed that funds should be returned to HUD. We summarized the Authority's comments in the Findings section of the report and included the Authority's response, without attachments, in Appendix B.

We conducted a separate audit of the relocation of HOPE VI residents by the Authority. The results of that audit are contained in Audit Report Number 2003-PH-1004 issued during September 2003.

We discussed the findings and recommendations with responsible Authority and HUD staff during the audit and at a meeting on June 9, 2003.

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Abbreviations

ACC	Annual Contributions Contract
BLI	Budget Line Item
CFR	Code of Federal Regulations
CSS	Community and Supportive Services
ED	Executive Director
HABC	Housing Authority of Baltimore City
HOPE VI	Homeownership and Opportunity for People Everywhere
HUD	U. S. Department of Housing and Urban Development
LOCCS	Line of Credit Control System
OIG	Office of Inspector General
OMB	U. S. Office of Management and Budget
PHA	Public Housing Authority
TDC	Total Development Cost

Introduction

The Housing Authority of Baltimore City (Authority) was organized in 1937 under the laws of the State of Maryland to develop, acquire and operate low-rent housing programs. A five member Board of Commissioners, appointed by the Mayor, governs the Authority. The Executive Director is Paul T. Graziano. The Authority's main office is located at 417 East Fayette Street in Baltimore, Maryland.

The Authority's Executive Director is also the Commissioner of Baltimore's Department of Housing and Community Development and the President and Chairman of the Board of the Baltimore Community Development Financing Corporation, a non-profit real estate development financing entity. Mr. Paul Graziano assumed these positions in November 2000. The Authority's prior Executive Director, Ms. Patricia Payne, served in those positions from February 2000 to October 2000. Mr. Daniel Henson III served in those positions from March 1993 until December 1999.

The Authority formed its HOPE VI (Urban Revitalization Demonstration) Office in 1994 to administer the HOPE VI projects' funds. The Office handled almost all aspects of administering the grants including: arranging for financing, evaluating contractors (including the selection of evaluation panel members), and negotiating price and contract terms. The Office also administered the contracts which included: changing the scope of work and contract specifications, issuing change orders, reviewing and approving invoices, monitoring the progress of the contractors, and resolving disputes.

Mr. Daniel Henson III was Executive Director when many of the key decisions were made relating to the HOPE VI activities we reviewed. At the time of his departure, Lafayette Courts was completed and Lexington Terraces was substantially completed. As such, Mr. Henson had overall responsibility of the HOPE VI Program that began with the receipt of the first HOPE VI Grant in August 1994. As Executive Director, he was responsible for setting the appropriate management tone and implementing controls to ensure the Authority implemented its HOPE VI Program effectively, efficiently, and economically and in accordance with the Grant Agreements and applicable rules and Regulations.

The current Executive Director disbanded the Hope VI Office in March 2001 and transferred those duties to the Development Office. In January 2002, this Executive Director arranged for HUD to provide a senior manager to perform as a full-time Development Advisor. The Executive Director also hired a Chief Financial Officer in order to improve the Authority's financial management operations. In December 2002, the new Chief Financial Officer: created and filled the position of Director of Procurement and Contracts and centralized all procurement activities and files under this position; automated the Authority's purchasing system to ensure accurate tracking of procurements and contracts; completed an internal assessment of the Authority's procurement and contract function; revised and streamlined the Authority's Procurement Policy in response to the assessment; and implemented standardized procurement documents and checklists. The Executive Director also hired: an Inspector General to fill a vacant position and the Inspector General now reports to the Board; and, a Deputy Executive

Director to assist in managing the Authority. In addition, the Authority hired an auditor to review its HOPE VI Program.

As of June 30, 1994, the Authority managed 18,052 dwelling units in 45 developments and scattered sites. As of June 30, 2001, the Authority reduced the number of units available for occupancy to 14,033. Most of this reduction was attributable to the demolition of six high rise developments: Lafayette Courts, Lexington Terraces, Hollander Ridge, Flag House Courts, Murphy Homes and Broadway Homes. As of June 30, 2001, the Authority completed construction of two developments, Lafayette Courts and Lexington Terraces. These two developments consisted of 404 rental townhouse units, 198 apartments for the elderly, and 127 homeownership units. In addition to the dwelling units, also constructed at Lafayette Courts were a Day Care Center, a Recreation Center, and a Community Center; and at Lexington Terraces a Business Center, a Drug Store, and a Computer Learning Center.

The HOPE VI Program permits expenditures for the capital costs of demolition, construction, rehabilitation, and other physical improvements; development of replacement housing; and community and supportive services. Public Housing Authorities (PHAs) are encouraged to seek new partnerships with private entities to create mixed-finance and mixed-income affordable housing that is different from traditional public housing projects. PHAs can use HOPE VI Program funds in conjunction with modernization funds or other HUD funds, as well as municipal and State contributions, public and private funds, and low-income housing tax credit equity. HUD awards HOPE VI Grants to PHAs on a competitive basis based upon applications to a Notice of Funding Availability. In 1999, the Authority was the second largest recipient of HOPE VI Grants.

At the beginning of our audit, the Authority received \$166,553,218 in HOPE VI funds to revitalize six developments. As of the audit date, the Authority estimated the total cost of its HOPE VI Program Implementation Grants from Federal and other sources to be \$412,391,823.

Development	HOPE VI Funds	Other Federal Funds ¹	All Non-Federal Funds	Total
Lafayette Courts	\$31,015,600	\$ 8,160,000	\$ 33,322,627	\$ 72,498,227
Lexington Terraces	22,702,000	28,372,545	28,195,911	79,270,456
Murphy Homes	31,325,395	0	26,370,174	57,695,569
Flag House Courts	21,500,000	265,000	43,456,000	65,221,000
Broadway Homes	21,362,223	5,870,556	27,352,671	54,585,450
Hollander Ridge ²	20,000,000	6,951,531	32,481,590	59,433,121
Consent decree ³	18,648,000	0	5,040,000	23,688,000
Total Budgeted	\$166,553,218	\$49,619,632	\$196,218,973	\$412,391,823
Percent of Budget	40.4%	9.2%	50.4%	100%

At the beginning of our audit work, the Authority reported to HUD expenditures of \$182,541,405, or 44 percent of the total amount of the Authority's HOPE VI Program budget.

Total Expenditures

Development	HOPE VI Funds	Other Federal Funds	All Non-Federal Funds	Total
Lafayette Courts	\$29,794,711	\$ 8,160,000	\$33,322,627	\$ 71,277,338
Lexington Terraces	21,806,523	28,372,545	28,195,911	78,374,979
Murphy Homes	10,900,092	0	0	10,900,092
Flag House Courts	7,312,562	0	0	7,312,562
Broadway Homes	1,133,475	5,870,556	0	7,004,031
Hollander Ridge	646,611	6,951,531	0	7,598,142
Consent decree	74,261	0	0	74,261
Total Actual	\$71,668,235	\$49,354,632	\$61,518,538	\$182,541,405

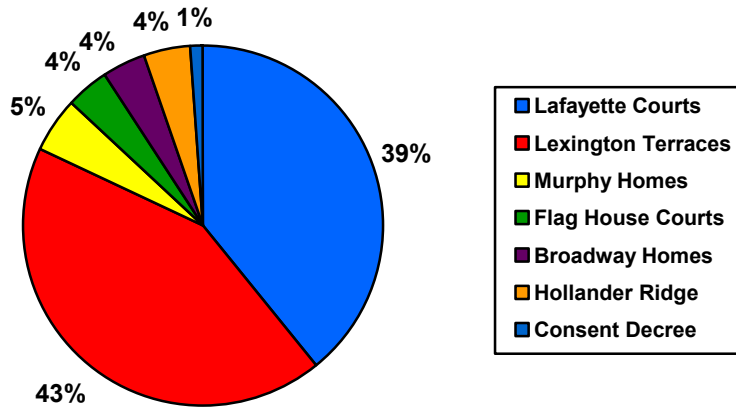
The amounts expended for Lafayette Courts and Lexington Terraces far exceeded the amounts expended for the other developments.

¹ Loans guaranteed under the Section 108 Program are included as Other Federal Funds.

² The \$20 million was originally budgeted for the revitalization of Hollander Ridge. However, a Senate amendment to the FY 2002 appropriations bill authorized the Authority to use the remaining balance of the grant for other purposes.

³ The Thompson Partial Consent decree dated June 25, 1996, required the Authority to utilize \$18,648,000 of the HOPE VI Grant funds, awarded for the redevelopment of Lafayette Courts, to create at least 168 homeownership units in non-impacted areas of the Baltimore housing market. On January 5, 2001, HUD split the Lafayette Revitalization Grant into two grants to better identify the consent decree funds since the 168 homeownership units were unrelated to the Lafayette site.

Comparison of Expenditures by Development



Funds expended for the revitalization of Lafayette Courts and Lexington Terraces totaled \$149,652,317 or about 82 percent of all funds expended for the Authority’s HOPE VI Programs as of June 30, 2001. As of that date, the Authority had substantially completed the revitalization of these two developments and initiated construction efforts for the revitalization of Murphy Homes. Since only two developments were completed and occupied as of that date, we focused most of our tests on those developments.

Audit Objectives And Scope

The objective of the audit was to determine if the Authority implemented its HOPE VI Grants effectively, efficiently, and economically and in accordance with the Grant Agreements and applicable rules and Regulations.

To accomplish our audit objectives we reviewed the Authority’s:

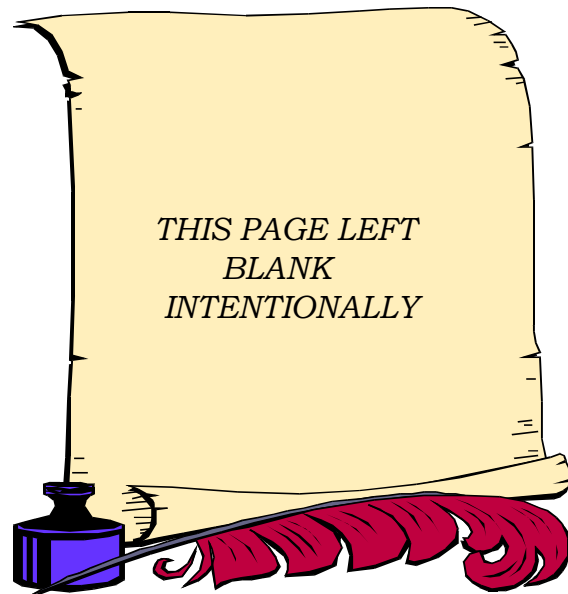
- Six HOPE VI Implementation Grant Agreements and applicable Federal laws and Regulations;
- HOPE VI applications and plans for Lafayette Courts and Lexington Terraces;
- Agreements and related correspondence files for building and developing Lafayette Courts, Lexington Terraces and Murphy Homes;
- HOPE VI accounting records;

- Requests for funds (nonstatistically selected 22 requests over \$1 million);
- Reports by independent public accountants for 1998, 1999, and 2000;
- Homeownership plans for Lafayette Courts and Lexington Terraces;
- Board meeting minutes; and
- Policies and procedures.

We interviewed and discussed issues with appropriate staff from: HUD's Office of Public Housing Investments and Office of Community Planning and Development; the Maryland State Office; the City of Baltimore; a non-profit real estate development financing entity; a contractor; a developer; and the Authority. We also held discussions with a former Deputy Executive Director and the former HOPE VI Director. We performed inspections at the revitalized sites and interviewed homeowners and public housing residents. In addition, we used Computer Assisted Audit Techniques to perform various functions during the audit.

We performed our initial audit work at the Authority between June 2001 and August 2002. The audit covered the Authority's operating period extending from May 25, 1993 through June 30, 2001. We primarily limited our review to transactions and events involving the revitalization of two developments, Lafayette Courts and Lexington Terraces. On occasion, we expanded the scope of our review to prior or subsequent periods, or other developments as necessary. We did not review the relocation of HOPE VI residents as part of this audit because we conducted a separate audit of that matter.

We performed the audit in accordance with generally accepted government auditing standards.



The Authority's HOPE VI Procurement and Contract Administration Practices Violated Regulations

The Authority did not procure and administer construction and developer services contracts in accordance with HUD requirements. Specifically, we noted procurement actions not documented, improper actions in contracting, and inadequate contract administration. These deficiencies occurred primarily because the former Executive Director (ED) did not establish an adequate internal control environment.⁴ As a result, the Authority incurred, for two developments, over \$28 million in costs that were in excess of HUD development standards.⁵

Criteria

Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, Subpart C, Section .300 (b) requires grantees to maintain internal control over Federal programs that provides reasonable assurance that the grantee is managing Federal awards in compliance with laws, Regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

The HOPE VI Grant Agreements between the Authority and HUD require the Authority to comply with HUD procurement requirements contained in 24 CFR 85.36, applicable HUD Handbooks and Notices, and all other applicable Federal requirements. Also, although not related solely to procurement, Title 24 CFR Part 24 allows HUD to take administrative actions against individuals who violate HUD's requirements.

⁴ An adequate internal control environment is one in which good business practices prevail and improper practices are less likely to occur and, if they do occur, are more likely to be detected and corrected. The appropriate management tone is set by top management and should enhance a Housing Authority's compliance with laws and Regulations. The environment affects an Authority's overall internal controls which should be designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (1) effectiveness and efficiency of operations; (2) reliability of financial reporting; and (3) compliance with applicable laws and Regulations.

⁵ The excess funds noted relate only to Public Housing funds. Additional funds from other sources totaling over \$22.2 million and \$31.4 million were spent for Lafayette Courts and Lexington Terraces, respectively.

High Dollar Contracts
Were Reviewed

We focused our review on three high dollar construction and developer service contracts valued at approximately \$169 million after we determined that the Authority's contract documentation was insufficient to allow review of other smaller contracts. Based on the amount of funds involved, we expected the Authority to adequately document the procurement process for these three contracts. However, we had a very difficult time locating the documents in the disorganized files of the Authority's HOPE VI Office and we requested managers to provide them. Despite an exhaustive search by current managers, the Authority was unable to provide a significant number of documents.

During the course of the audit, we identified numerous instances where the Authority did not procure and administer construction and developer services contracts in accordance with Federal and HUD requirements. These specific instances are detailed below.

A. Procurement Actions Not Documented

Contrary to HUD requirements, the Authority did not maintain records sufficient to detail the significant history of its procurement actions. Managers were either not aware of, or disregarded, HUD's requirements. As a result, the Authority had no assurance that its selection of developers was objective, consistent, and fair and could not demonstrate that the developer's fee was reasonable. Furthermore, although a designated Custodian of Records exists, the HOPE VI Office did not always forward the appropriate documents to the Custodian for safekeeping.

Title 24 CFR 85.36(b)(9) requires the Authority to maintain records sufficient to detail the significant history of a procurement. HUD Handbook 7460.8 Rev-1, Paragraphs 4-23.D. and 4-24.D. also require specific documentation requirements relating to procurement actions.

Evaluation Of Proposals
Was Not Documented

The Authority did not adequately document the evaluations of proposals received. Plans of the Authority for evaluating the proposals required panel members to provide scores as well as narratives explaining how they developed the scores. In many cases, either the panel members did not provide narratives for the scores or the Authority could not locate the evaluation sheets of the panel members.

Analysis And Negotiation
Of Developer's Fees Was
Not Documented

Furthermore, for Lexington Terraces, the Authority only solicited prequalified firms but did not maintain necessary documents relating to the pre-qualification process.

Also, the Authority did not document the analysis and negotiation of the developer's fees for Lexington Terraces and Murphy Homes. The Authority's Development Director said the fees were negotiated based on historical data and at the prevailing rate in Maryland. The Director was unable to provide evidence of negotiations or analyses performed in order to justify agreed upon fees.

Further, the Authority's former Custodian of Records said he believed that the HOPE VI Office should have forwarded him the evaluations, analyses, and negotiation records. However, the HOPE VI Office did not provide the documents to the Custodian for safekeeping. Consequently, we were unable to ascertain whether or not the documents or analyses were actually prepared or if the documents were simply not forwarded and subsequently lost.

B. Improper Actions in Contracting

We found the former Executive Director: provided HUD misleading information; did not promptly disclose conflicts of interest to HUD; modified standard contract clauses without approval; and limited competition. These deficiencies occurred because of the Executive Director's apparent disregard to adhere to the applicable Federal and HUD procurement requirements and overall mismanagement of the HOPE VI Program. As a result, the Authority: incurred costs that exceeded HUD development standards by \$19,227,051 for one development⁶; incurred costs that exceeded HUD development standards by \$9,305,595 for another development; had no assurance that other development costs were reasonable; and could not demonstrate that its developer selection process was objective, consistent, and fair.

Misleading Information
Was Provided To HUD

The Authority received two proposals resulting from a publicly advertised Request for Proposal (RFP) for a build/design contract for the revitalization of Lafayette Courts. However, one bidder withdrew its proposal before

⁶ Of this amount, we computed the builder was paid \$11,977,622 more than necessary.

the bid opening. The bidder objected to senior Authority and City of Baltimore officials appointing voting members to the evaluation panel. Further, the bidder wanted HUD to select independent experts to select the voting panel members to avoid any question of favoritism.

An Authority consultant determined that the eventual \$52.3 million final contract price, proposed by the remaining builder, was fair and reasonable. However, the consultant's analysis excluded value engineering changes, losses in square footage, and contingency fee adjustments in determining the reasonableness of the contract price. The former Executive Director apparently disregarded the selection panel's recommended option to declare the builder's proposal non-responsive and to consider other alternatives including soliciting new proposals.

In addition, the former Executive Director submitted the inaccurate information from the consultant's analysis to HUD in connection with his request to HUD to award the contract to the single bidder. According to the former Executive Director's request, the contract cost for the reconstruction of the Lafayette Courts was fair and reasonable and within 5 percent of the Authority's pre-bid estimate. HUD used the former Executive Director's representation as one of the bases to approve the award of the contract. However, the former Executive Director's representation, based on the consultant's analysis, was inaccurate because the contract with the single bidder was overpriced by \$11,977,622, or about 30 percent, when adjustments for changes were considered. We believe, based on the former Executive Director's experience in the field, he should have known the analysis was incomplete and the price was unreasonable. It appears the former Executive Director made the assertions in order to obtain HUD's approval to award the contract.

Conflicts Of Interest Were Not Promptly Disclosed To HUD

Concerning work at Lafayette Courts, the former Executive Director did not timely or fully disclose to HUD all details concerning a conflict of interest situation involving his sister. Based on a local newspaper report on the conflict of interest situation, HUD began to inquire about the matter. The former Executive Director's sister was a subcontractor and member of the design/builder's team. HUD retroactively granted a waiver based on a legal opinion

from the Authority's Counsel. In the opinion, Counsel stated its understanding was that the former Executive Director disclosed the conflict to the Board. However, the Board's minutes did not report that the former Executive Director disclosed the conflict to the Board, as required by HUD and State law.

Also, in an effort to resolve the conflict of interest, the former Executive Director informed HUD that his sister was a subcontractor to another firm, which was a subcontractor to the general contractor for Lafayette Courts. The Executive Director apparently made the assertion in order to resolve the issue with HUD. However, the Executive Director did not subsequently disclose that the day after he made this statement to HUD, the general contractor executed an agreement directly with the Executive Director's sister. The general contractor also issued an additional order to the sister. These orders totaled \$221,764.

Former Executive Director Awarded A Contract To His Former Employer

Concerning work at Lexington Terraces, the former Executive Director awarded the developer contract to his former employer, which constituted a conflict of interest. The former Executive Director was also in debt to the firm and owned limited partnership interests in several projects with the principal of the firm. The Authority's Counsel found no conflict in the transaction and HUD waived the conflict. Although HUD later determined that the transaction constituted a prohibited conflict of interest, the waiver was upheld. Because of the significant amount of time and money already invested in the project, HUD concluded that allowing the revitalization process to continue rather than terminating the involvement of the developer would better serve the public's interest.

Actions Violated HUD Requirements And State Law

The above actions violated a number of HUD requirements and State law as follows.

- Title 24 CFR 85.36(b)(3) requires that no employee, officer, or agent of the grantee shall participate in the selection, or in the award or administration of a contract supported by Federal funds, if a conflict of interest, real or apparent, would be involved.

- Further, Article XV.1., Conflict of Interest, of the Lafayette Courts and Lexington Terrace HOPE VI Grant Agreements between HUD and the Authority states:

“In addition to the conflict of interest requirements in 24 CFR part [sic] 85, no person who is an employee, agent, consultant, officer, or elected or appointed official of the Grantee and who exercises or has exercised any functions or responsibilities with respect to activities assisted under this HOPE VI grant, or who is in a position to participate in a decision-making process or gain inside information with regard to such activities, may obtain a financial interest or benefit from the activity, or have an interest in any contract, subcontract, or agreement with respect thereto, or the proceeds thereunder, either for himself or herself, or for those with whom he or she has family or business ties, during his or her tenure or for one year thereafter.”

Paragraph 2. of the Article above provides that HUD may grant an exception to the conflict of interest requirements on a case-by-case basis. For an exception to be considered, the Grantee has to provide HUD a disclosure of the nature of the conflict accompanied by, among other items, an opinion of the Grantee’s attorney that the interest for which the exception is sought does not violate State or local laws. As we described above, the former Executive Director did not fully comply with this provision.

- Article 44-A, Section 1-211 of the Annotated code of Maryland required that such conflict be immediately disclosed in writing to the Authority Board and the disclosure must be entered in the Board’s minutes. Failure to disclose such interest shall constitute misconduct in office. We found no evidence this requirement was met.

Standard Contract Clauses
Were Modified Without
Approval

The former Executive Director also issued the contract to rebuild Lafayette Courts with modified clauses before submitting the contract to HUD for review and approval. One modified clause restricted access by the Authority,

HUD, and others, to the contractor's books and records, contrary to Regulations. The Executive Director apparently disregarded this requirement since we did not find evidence that he attempted to correct this deficiency even though a HUD reviewer subsequently notified the Authority that it could not modify standard HUD clauses without written approval from HUD's Assistant Secretary for Public Housing.

The modified contract clause concerning access to records prevented the Authority's internal auditors from gathering information about a deficient security system, valued at \$145,150, provided by the contractor. Our review disclosed the Authority did not have evidence it inspected the system prior to making payment. During our onsite inspection in March 2002, only 24 of 38 surveillance cameras were working leaving 14 areas unobserved. Since the Authority did not inspect and certify the security system was working before final payment for the system, we do not know if these cameras ever functioned properly.

Authority auditors attempted to perform an audit of the security system before our onsite work commenced, but were unsuccessful because the contractor and the Authority's HOPE VI Office was non-responsive to their requests for information. Although the auditors tried, they were unable to remove the impediments that obstructed their review.

Title 24 CFR 85.36(i)(10) requires the Authority's contracts to contain provisions that include, among others, access by the Authority, HUD, and the Comptroller General of the U. S., or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions. In addition, the Lafayette Courts HOPE VI Grant Agreement, Article IX, paragraph 4., requires the grantee to submit to HUD, for prior approval, a copy of the proposed construction contract before award.

Competition Was Limited

The former Executive Director did not acquire developer services for Lexington Terraces using full and open competition as required by 24 CFR 85.36(c). In the process, the former Executive Director only solicited

proposals from four pre-qualified developers. The ED did not advertise the solicitation or make it available either to other pre-qualified developers or to prospective developers who were not pre-qualified. Although HUD was aware of the process and approved the awarding of the contract to the selected developer, the Executive Director's actions raised doubts as to whether the selection process was fair.

In addition, the former Executive Director allowed the selected developer to award itself a construction contract without bidding the contract as required by the Grant Agreement. Although HUD was aware of and approved the awarding of the construction contract, the Authority had no assurance that the construction cost for this development was fair and reasonable. Instead of competing the construction contract, HABC relied upon State of Maryland requirements for limiting fees when identity of interest situations exist between the developer and the contractor. The cost (Public Housing funds) of the dwelling units at this development exceeded HUD development standards by \$9,305,595, or 25.5 percent. Authority personnel could not demonstrate why the cost of dwelling units exceeded the HUD standards.

C. Inadequate Contract Administration

The Authority did not properly administer its HOPE VI Contracts. Specifically, the Authority did not review cost analyses or obtain prior approvals for Lafayette Courts and Lexington Terraces contract modifications and the Authority also split change orders to avoid HUD reviews. This occurred because staff did not communicate the need for cost analyses to on-site representatives and staff did not follow HUD requirements. As a result, the Authority may have incurred unnecessary and unreasonable costs and may have incurred costs that HUD may not have authorized.

For Lafayette Courts and Lexington Terraces construction and developer contracts, the Authority issued 28 change orders either increasing or decreasing the contract value by more than \$25,000. The value of the 28 change orders totaled \$2,282,755. Specifically, we noted that the Authority:

- did not review cost analyses for any of these 28 change orders because it did not communicate the need to document the analyses to its on-site representatives. As a result, the Authority may have incurred unnecessary and unreasonable costs since it did not have a sufficient basis to negotiate costs. Title 24 CFR 85.36(f)(1) requires grantees to perform a cost or price analysis.
- did not obtain prior approvals from HUD for 16 change orders totaling \$1,207,123. By means of a Corrective Action Order, HUD directed the Authority to obtain approval for contract modifications over \$25,000. Authority managers apparently disregarded HUD requirements to obtain approvals. Although HUD eventually approved these change orders, this process left the Authority liable for funding change orders that HUD may not have authorized. In addition, the Authority issued six change orders totaling \$754,814 for Lafayette Courts without providing the date the Authority issued the change orders. As a result, we were unable to determine if the Authority issued the change orders before obtaining HUD's approval. The remaining six change orders, totaling \$320,818, were either undated or approved by HUD, or did not require approval because they decreased the contract price.
- split three change orders, totaling \$185,237, from the Lafayette Courts contract to avoid required HUD reviews of change orders in excess of \$25,000. HUD Handbook 7460.8 Rev-1, Paragraph 4-3 A. prohibits the splitting of change orders. In one case, HUD rejected a change order submitted by the Authority for "Management and Events Services" at Lafayette Courts. Subsequently, the former ED issued five change orders totaling \$89,148 for the services. In a second case, the Authority issued two change orders totaling \$28,229 for design services and furnishings. These change orders were issued to a firm owned by the former ED's sister. In the third case, the Authority issued three split change orders totaling \$67,860 for design

services and furnishings. These change orders were issued to another subcontractor.

In summary, the primary cause of the deficiencies noted above was the former Executive Director did not establish an adequate internal control environment as required. Apparently, the former Executive Director did not want to be restricted by internal controls. The former Executive Director ignored many of the applicable Federal Regulations and Authority procedures, and made decisions that indicated a lack of concern regarding the financial health of the Authority and the efficiency of its operations. The Authority incurred, for two developments, over \$28 million in costs that were more than TDC limits.

Corrective Action Taken
By The Auditee

During the audit, we discussed the deficiencies with the current Executive Director. In response to our concerns, he developed, and the Authority's Board approved, a Procurement Policy that included, but is not limited to:

- disclosing apparent or real conflicts of interest and obtaining advance waivers from HUD before awarding contracts;
- incorporating required clauses in all HOPE VI contracts;
- utilizing full and open competition in the procurement of future HOPE VI developer contracts and not limiting distribution of solicitations only to those that are pre-qualified;
- documenting procurement actions and retaining records sufficient to detail the significant history of procurements as part of the procurement files;
- preparing and documenting cost analyses and including these analyses in the procurement files, before negotiating change orders; and
- submitting contracts and contract modifications exceeding the established threshold for HUD review and approval before issuance.

Since the Authority took corrective action, we did not make recommendations relating to these issues.

Auditee Comments

The Authority noted that the HUD Total Development Cost (TDC) process in effect at the time of the Lafayette (1994) and Lexington (1995) HOPE VI Grants was derived from the public housing industry's experience with the modernization of existing public housing sites. It was thus inappropriate and unworkable for the HOPE VI Program, which contemplated the wholesale demolition and redevelopment of complex urban neighborhoods. HUD recognized the problem by consistently granting waivers or exceptions from the TDC limits in these grant years, and by totally revamping the TDC process – and significantly raising the TDC limits – in the 1999 grant year. The Authority made the expenditures necessary to meet the real-world requirements of redeveloping the distressed urban sites that were Lafayette and Lexington, and did so with HUD authorization. In conclusion, the Authority stated if it were not to have made these full expenditures, the Lafayette and Lexington projects would not have been completed, or would only have been partially completed, to the significant detriment of the hundreds of public housing residents who are now enjoying safe and productive lives in these neighborhoods.

OIG Evaluation of Auditee Comments

The Authority's comments are noted. According to HUD officials, the average TDC limit was raised for the 1999 grant year to provide for costs associated with better quality housing than for the pre-1999 grant years. The report details various instances where the prior Executive Director provided misleading comments to HUD relating to the development activities. Because HUD did not have all the facts, it granted waivers to exceed HUD's TDC and award contracts. Despite the Authority's assertions that the projects could not have been completed without HUD's waivers, these waivers only pertained to the use of the Public Housing Funds and did not address more than \$53.6 million of other Federal, State, City (HUD guaranteed loans), and private funds also invested in these two developments.



Recommendations

We recommend that you:

- 1A. Based on the information in this finding and in this report, take appropriate administrative action against the former Executive Director.

The Authority Did Not Maintain Accurate Financial Records

The Authority's financial management of the HOPE VI Program was weak and managers did not maintain financial records in accordance with numerous Federal requirements. Specifically, we noted instances where the Authority: (1) did not follow HUD requirements when drawing funds from the HUD Line of Credit Control System (LOCCS); (2) did not maintain accurate and complete accounting records; and (3) displayed various other inadequate financial management practices. These deficiencies occurred because Authority managers did not provide appropriate supervision and oversight and had not established procedures to ensure compliance with Grant Agreement requirements and Federal and HUD Regulations. As a result, the Authority's financial management of the HOPE VI Program produced, among others, the following deficiencies:

- funds drawn from LOCCS totaling more than \$31.7 million could not be readily supported;
- accounting records contained errors in excess of \$37.2 million and disagreed with HUD's records by about \$27.9 million;
- HUD approved development costs were exceeded by over \$2 million for one development and the Authority was not aware it was going to exceed approved costs for another development; and
- the Authority inappropriately retained duplicate funding of \$916,995.

Because of the lack of procedures and accounting errors, managers were unable to effectively manage funds and their ability to make effective management decisions was impaired. Also, the status of the records impaired HUD's ability to provide effective oversight and caused us and Authority personnel to spend an inordinate amount of time trying to identify the actual costs related to the HOPE VI Program.

Criteria

The Lafayette Court and Lexington Terraces Grant Agreements, Article XIII.1., require the Authority to keep accurate and complete records that facilitate an effective audit.

Title 24 CFR 85.20(b) requires the grantee's financial management system to meet certain standards, including, in

part, the following: accounting records that adequately identify the source and application of funds; effective internal controls and accountability over funds; source documentation that supports accounting records to include cancelled checks, paid bills, payrolls, time and attendance records, contract and award documents, etc.

A. The Authority Did Not Follow HUD Requirements When Drawing Funds From the HUD Line of Credit Control System (LOCCS)

The Authority could not provide us support for the use of \$31,775,341 because it did not follow HUD requirements that the source and application of funds be adequately documented and the Authority requested funds in amounts that avoided HUD reviews. Furthermore, Authority managers did not authorize draws as required by HUD. The Authority's poor financial management practices were due to lack of supervision and oversight. As a result, we have limited assurance that the Authority used HOPE VI funds only for expenses authorized under HUD Regulations and the Grant Agreements. Also, HUD reliance upon data recorded in LOCCS was impaired and likely affected HUD's ability to provide effective oversight of the Authority's HOPE VI Program.

During the period December 12, 1994, through June 30, 2001, the Authority drew HOPE VI funds totaling \$86,519,499 from HUD using HUD's LOCCS. We selected 22 draws over \$1 million for review to determine if the Authority complied with HUD financial requirements. These draws, totaling \$40,589,803, ranged from \$1,007,993 to \$3,793,466 and represented 47 percent of the total HOPE VI draws.

LOCCS Draws Were Not Adequately Supported

Of the 22 draws totaling \$40,589,803, the Authority's files did not contain adequate documentation to appropriately identify the use of HOPE VI funds for 17 of the LOCCS Vouchers totaling \$31,775,341. Of these 17 draws:

- Ten Budget Line Item (BLI) draws, totaling \$18,068,063, were for LOCCS Vouchers that totaled large round dollar amounts (for example, \$2,400,000 and \$1,100,000). These amounts were just under the applicable five percent thresholds that

would cause HUD to question the draws. The Authority could not provide us specific invoices to support the BLI draws.

- Seven BLI draws, totaling \$13,707,278, contained invoices, schedules, or other records that did not support the BLI amount.

Authority accounting personnel claimed the BLI amounts were supported because they prepared schedules that detailed the amounts paid to contractors. However, these schedules did not agree with the specific draws. Further, Authority accounting personnel explained that LOCCS sometimes prevented them from drawing funds because the HOPE VI Office did not submit quarterly monitoring reports when required. This required the accountants to submit draws to “catch-up” to amounts previously paid to contractors. In addition, accounting managers stated the Authority routinely paid contractors before requesting HUD funds because the Authority had excess cash and would draw funds to “catch-up” when it needed cash. Regardless of the reason, the Authority should have maintained adequate documentation as required.

LOCCS Procedures Were Lacking

The lack of adequate documentation for the draws occurred, in part, because the Authority did not have procedures governing LOCCS draws that required the accountants to identify specific invoices or other supporting documentation when completing LOCCS Vouchers. We also attributed the lack of discipline over the LOCCS draws to the Authority’s lack of procedures that would require an individual to review and authorize (sign) LOCCS Vouchers. Form HUD-50080-URP is used for drawing HOPE VI funds from LOCCS. It provides for: the recording of expenses by BLI and an official to authorize the transfer. HUD addressed the lack of authorizing signatures in its December 1999 monitoring review, however, the Authority took no action. Although we discussed the need to have LOCCS Vouchers authorized by a designated individual with accounting managers during the audit, these officials failed to take appropriate corrective action to ensure LOCCS Vouchers are properly authorized.

B. The Authority Did Not Maintain Accurate and Complete Accounting Records

The Authority's accounting records contained numerous errors and were incomplete. Specifically, we noted the Authority:

- accounting records contained errors, totaling \$37,221,528;
- accounting records and the information recorded in HUD's LOCCS financial management system differed by about \$27,900,000;
- funded the same requirement valued at \$916,995 with two different funding sources;
- did not account for a loan valued at \$164,500 or for income totaling \$728,115; and
- did not collect \$440,666 for the sale of 17 townhouses from an entity controlled by a former ED.

These deficiencies occurred because the Authority did not have adequate procedures to ensure it recorded transactions in compliance with Title 24 CFR 85.20(b). As a result, the ability of the Authority's managers to make decisions based on its financial records was impaired and HUD's ability to provide effective oversight was impaired.

Details related to the matters we identified during our review follow:



Inaccurate Accounting Records

Authority staff found many financial record errors when they performed a reconciliation of the Lafayette Courts HOPE VI Program costs. Accounting personnel performed this reconciliation because of questions we raised during the audit. From their review, they found amounts recorded for the \$54,224,339 construction contract required adjustments totaling \$37,221,528. Authority staff were not able to explain how these errors occurred.

However, during our review of LOCCS draws and other transactions, we noted the lack of defined accounting

procedures resulted in a number of instances where poor accounting practices contributed to these errors. For example, Authority accountants:

- recorded invoiced costs against incorrect BLIs and funding sources.
- transferred costs among BLIs and other funding sources without adequate support.
- did not verify HOPE VI managers' distribution of expenses, as recorded on memorandums, among BLIs and funding sources.
- processed an unreasonable number of requests for transfers of expenses created by the HOPE VI Office.

During our review of transactions relating to “for-sale” dwellings, we noted other instances of incomplete and inaccurate records.

Sale Of Lafayette Courts Units Occurred Off The Books

The HOPE VI Office established “off the books” procedures that caused accounting records to be incomplete and inaccurate. These procedures related to a loan for the construction and sale of 27 Lafayette Courts townhouses. Rather than coordinating the townhouse financing with the Comptroller’s Office, the HOPE VI Office borrowed \$164,500 directly from a financing entity controlled by a former Executive Director. The Office arranged for title companies processing the sale of 17 units to forward the proceeds directly to the financing entity.

Because of the “off the books” procedures, the Authority did not record excess loan payments, totaling \$440,666 from the sale of the 17 townhouses, as a receivable. The financing entity’s staff said that although they were aware the funds should have been returned to the Authority, a former Executive Director directed the related entity to retain the funds.

Title companies forwarded the Authority \$355,292, for the remaining ten townhouses. The Authority correctly recorded \$67,843, for the sale of two townhouses as program income. However, contrary to HUD requirements it did not accurately

record, as program income, the funds related to the remaining eight townhouses that totaled \$287,449.

Title 24 CFR 85.25(b) defines program income as gross income received by the grantee directly generated by a grant supported activity, or earned only as a result of the Grant Agreement during the grant period. Further, 24 CFR 85.25(g)(1) requires that program income shall be used for current costs unless the Federal agency authorizes otherwise.

Accounting Records Did Not Support LOCCS Draws

Our comparison of the amounts recorded in the Authority's accounting records to information recorded in LOCCS for Lafayette Courts' and Lexington Terraces' HOPE VI Grants disclosed discrepancies totaling approximately \$27,900,000.

Analysis of the records for the Lafayette Courts Grant disclosed there was little correlation between the amounts. The amounts recorded between the Authority's accounting records and LOCCS for Lafayette Revitalization Grant BLIs varied more than \$27,600,000 for the \$31,015,600 grant because accounting personnel prepared LOCCS Vouchers that forced amounts to agree with the amounts authorized in LOCCS for each BLI. For example, LOCCS reports for BLI 1470, Non-dwelling Units, contained expenses that were the same as the authorized amount, \$119,000. However, the Authority's HOPE VI accounting records reflected expenses totaling \$10,851,620, a variance of \$10,732,620.

Although there were discrepancies between the Authority's accounting records and HUD's LOCCS records for the Lexington Terraces Grant, they were not as significant as the Lafayette Courts Grant discrepancies. The amounts recorded for the Lexington Terraces Grant's accounting records disagreed with LOCCS BLIs by \$292,950 for the \$22,702,000 grant. For example, LOCCS reports for BLIs 1475 and 1495, Non-dwelling Equipment and Relocation Costs respectively, contained expenses totaling \$20,000, and \$250,000 while the Authority's accounting records reflected expenses of \$799 and \$61,981 respectively. Although we were unable to discern the reason for the variances, we suspect it was due to the transfer of previously recorded expenses to other funding sources.

Duplicate Funding

Our comparison of the amounts recorded in the Authority's accounting records to information recorded in LOCCS for the Lafayette Courts Grant disclosed the Authority drew \$985,962 in excess of expenses recorded in its accounting records. This condition occurred because the Authority initially recorded expenses under the HOPE VI Account and later recorded the same expenses under the Section 108 Account which was established when the City provided funds under HUD's Section 108 Program. The recording of the accounting transactions resulted in the Authority receiving excess funding in the HOPE VI Account.

Although Authority managers were aware of this situation, they were reluctant to return the funds to HUD because they believed they could use the funds for other purposes. Even though the Authority reported the financial information to HUD on a quarterly basis, HUD had not detected the over-funding because they did not place emphasis on reviewing the reports but instead relied upon information recorded in LOCCS.

The Lafayette Revitalization Grant Agreement Article XIV, paragraph 4, states that the grantee agrees that the expenditure of grant funds is allowable only for expended project costs and only to the extent that other sources of funds identified in the HOPE VI Application are not available for payment of such project costs. Article II, paragraph 1, states that the grantee's application means the application made in response to the Notice of Funding Availability (NOFA), together with submissions permitted after the application deadline, other information submitted, and includes the Revitalization Plan. Article IV, paragraph 8, states that the grantee will ensure that HOPE VI Grant funds are not used to duplicate work which is funded under any other Federal program, and will establish controls to assure non-duplication of funding.

Title 24 CFR 570.704 (c)(5) requires a public entity, which plans to carry out an activity not previously described in its Section 108 application, to amend its application and obtain HUD approval. The public entity is also responsible for following the public participation requirement for amendments by providing affected citizens with reasonable advance notice of, and opportunity to comment on,

The Authority Transferred Expenses That Violated HUD Requirements

proposed activities not previously proposed in the application.

After we brought the matter to the attention of Authority officials, the Authority, through a series of accounting transactions, fully expended the remaining HOPE VI funds at that time totaling \$916,995.

Unfortunately, one transaction that transferred expenses totaling \$172,916 from the HOPE VI Account to the Section 108 Account violated both the HOPE VI Grant agreement and the terms of the City's Section 108 loan application.

The Authority's Revised Revitalization Plan dated September 1997 identified \$8,160,000 of Section 108 monies as a funding source for the Revitalization of Lafayette Courts. Therefore, use of the HOPE VI funds totaling \$916,995 to pay for expenses previously charged to the Section 108 Account was in violation of the Grant Agreement since it required usage of the Section 108 funds first. Authority personnel were unaware of the requirement to utilize the Section 108 funds before the HOPE VI funds and believed it was acceptable to use the Section 108 funds for other purposes. Additionally, the Authority returned the \$916,995 to the City because management believed it was appropriate. Furthermore, the Authority's transfer of expenses from the HOPE VI Account to the Section 108 Account violated the terms of the Section 108 loan application because the City did not: amend its application; obtain HUD approval in advance; and seek public participation.

C. Other Weaknesses In the Authority's Financial Management Practices

During the audit, we noted several other instances where the Authority's financial management was weak. The Authority exceeded HUD approved development costs by \$2,067,637 for one development and was not aware it would likely exceed approved costs for another development. Also, the Authority: prematurely drew funds from LOCCS for contract retainage; inappropriately charged a vehicle to a HOPE VI grant; did not completely process payments in the Accounting System; did not properly maintain petty cash funds; and did not report all loans in its financial statements.

Generally, the Authority did not have procedures that would have prevented these conditions from occurring, and in situations where it had established procedures, personnel simply did not follow them. Because of the lack of attention to procedures, Authority managers were unable to effectively manage funds and their ability to make effective management decisions was impaired.

Approved Development Costs Were Exceeded

The Authority exceeded the HUD approved use of public housing funds totaling \$46,266,219 for Lafayette Courts by \$2,067,637 because the Authority issued change orders that increased the cost of the development and spent fewer funds from other funding sources than planned. Authority staff had not determined they had exceeded approved development costs because they had not compared funds expended to funds authorized for the development.

Authority staff also had not determined the complete costs for Lexington Terraces because they had not completed their reconciliation efforts. However, using available reports we determined the Authority will exceed the development's original planned costs by at least \$2,729,628. Of this amount, \$1,763,035 will be public housing funds. Other funding sources will absorb the remaining expenses totaling \$966,593. Development Office staff took exception with our calculations and said that the Authority intends to reduce planned expenses by spending \$1,594,600 less on a Community Center yet to be constructed. However, the Authority had not yet obtained HUD approval for this change. Regardless, the Authority expects the development to cost at least \$1,135,028 more than originally planned. Of that amount, \$218,435 will be public housing funds.

The Lafayette Courts and Lexington Terraces HOPE VI Grant Agreements, Article X.1, require HUD approval before exceeding HUD approved costs. Since the Authority did not obtain HUD approval before spending the public housing funds totaling \$2,067,637 for Lafayette Courts, the Authority needs to return these funds to HUD. Additionally, the Authority needs to complete its reconciliation for Lexington Terraces and notify HUD of any costs that exceed the HUD approved total development costs.

We also noted that the Authority did not have procedures to enter budgetary information into the accounting system that would alert managers when actual costs did not agree with budgeted amounts. Title 24 CFR 85.20(b)(4) requires that actual expenditures or outlays must be compared with budgeted amounts for each grant. As a result, managers and others did not have a valuable tool that would highlight the need to investigate the variances and to take appropriate management action.

Retainage Fees Were Drawn Prematurely

The Finance and Accounting Department inappropriately prematurely drew contract retainage amounts totaling \$302,497 for two draws in our review of LOCCS transactions. Title 24 CFR 85.20(b)(7) stipulates that draws should not exceed the amount needed to meet the immediate disbursement requirement of the grantee. Typically, the Authority should withhold a percentage of funds (retainage) from contractors performing demolition or construction work and should not pay until it accepts all work at the completion of the project. Accounting personnel were not aware of the requirement to draw funds only as needed and believed it was appropriate to draw the full amount. We discussed the issue of retainage with accounting managers and during the audit they developed procedures that required drawing funds for retainage amounts at the completion of projects.

Vehicle Was Improperly Charged To Lafayette Courts' HOPE VI Grant

The Authority acquired a vehicle valued at \$15,937 using Lafayette Courts revitalization grant funds. However, the Training and Mobility Office did not use the vehicle for Lafayette Courts grant purposes. Office staff said they used the vehicle to relocate residents of other HOPE VI sites.

OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, provides principles for determining allowable costs for Federal awards. Attachment A, Subsection C.1., item a., of the Circular stipulates that costs must be necessary and reasonable for proper and efficient performance and administration of Federal awards.

Payments Were Not Completely Processed In The Accounting System

The Authority consistently recorded payments to one contractor but did not completely process the payments through the accounting system. Specifically, we found the Authority accounting staff did not process payments, totaling \$54,224,339, to Pleasant View Gardens' Design/Builder through the Accounts Payable System. Accounting

managers said staff processed the payments to the builder by electronic fund transfers in order to speed the payments to the builder. As a result, the Authority did not establish an audit trail sufficient to identify payments to this contractor. Therefore, managers and others who relied on information from the accounting system were not provided with complete data.

OMB Circular A-87 provides principles for determining allowable costs for Federal awards. Attachment A, Subsection C.1., item j., of the Circular states that costs must be adequately documented and consistently treated.

Accounting managers said they changed the process for recording electronic fund transfers so that payments are now completely processed. However, the Authority did not have documented procedures requiring the recording of electronic fund transfers in the Accounts Payable System.

Petty Cash Funds Were
Not Properly Maintained

The Authority could not account for \$1,000 of \$1,250 reported as petty cash on hand as of June 30, 2001. Accounting personnel stated they provided the cash from HOPE VI funds for the revitalization of Lafayette Courts but could not initially identify the petty cash custodian because they did not maintain an updated list of custodians. We could only account for \$250 of the \$1,250, and the Authority used those funds for the reimbursement of expenses not related to Lafayette Court revitalization. Additionally, the \$250 was in the possession of an individual other than the person accounting staff believed was the custodian. Although the Authority had procedures for a Central Petty Cash fund and other funds, the Authority's procedures did not provide for maintaining a comprehensive list of petty cash custodians or transferring funds when custodians changed. As a result of poor controls over petty cash, \$1,000 of petty cash is unaccounted for, the remainder was spent for expenses not related to the grant, and the custodian of the petty cash could not be identified.

Title 24 CFR 85.20 (b)(3) requires effective control and accountability be maintained for all grant cash. The Authority needs to account for the missing funds. Since the grant to which these funds apply is complete, the Authority needs to return the value of the petty cash account to HUD so it can use these funds to revitalize other developments.

Impaired Loans Were Not Reported

The Authority did not report loans resulting from the sale of dwelling units in its annual financial statements. The value of the loans, resulting from the sale of 27 units at Lafayette Courts, totaled \$660,666. The Authority placed liens against these properties and HABC will forgive the loans over a ten-year period. The value of the loans resulting from the sale of 100 units at Lexington Terraces was not readily apparent because the Authority did not record the liens. Instead, the Authority placed wording in the deeds that required the buyers to return to the Authority a percentage of the gains on the properties, if the buyers sold the property within ten years. Accounting managers were unaware of the loans because the HOPE VI Office did not establish procedures to notify the accounting managers of the existence of the loans.

Title 24 CFR 85.20(b)(1) requires financial reports be accurate, current and provide for complete disclosure of the financial results of activities. Generally Accepted Accounting Principles require disclosing the loans in the financial statements or accompanying notes. If it is probable that a mortgage is not likely to be collected, it is an impaired loan.

Corrective Action Taken By The Auditee

HUD staff informed us they visited the Authority after we ended field work and they concluded the \$31,775,341 for funds drawn from LOCCS is now supported. During the audit, we discussed issues relating to LOCCS draws with the new Chief Financial Officer. As a result of those discussions, the Authority developed LOCCS Drawdown Procedures. These procedures required staff to:

- identify invoices and other supporting documents when completing LOCCS Vouchers;
- review and authorize LOCCS Vouchers before submitting the payment requests to HUD;
- record sales of dwelling units on the accounting records;
- record electronic funds transfers in the Accounts Payable System; and

- periodically compare accounting records to information recorded in LOCCS and take appropriate action to research and correct variances.

These procedures also required:

- the Accounting Department to verify the distribution of expenses among BLIs and funding sources, as stated in the HOPE VI Office's memorandum; and
- the Development Office to provide the Accounting Department with supporting contracts, schedules, reports, and other documentation that would assist the Accounting Department to verify charges to BLIs and funding sources.

In addition, the Chief Financial Officer also accounted for the missing petty cash and made appropriate accounting entries related to the cash.

Since the Authority took corrective action on these matters, we did not make recommendations relating to these issues.

During the audit, we also notified the current Executive Director about the program income totaling \$440,666 that the financing entity retained and he took appropriate action by recouping those funds and recording \$728,115 from the sale of townhouses as program income. However, by means of accounting entries, the Authority recorded all proceeds, totaling \$795,958 from the sale of the 27 townhouses, in an account not associated with the Lafayette HOPE VI Revitalization. The Chief Financial Officer took this action because management believed it could use the funds for other purposes.

Auditee Comments

The Authority agreed with our recommendation to improve accounting for grant funds. However, the Authority disagreed that accounting transactions totaling \$3,796,527 needed to be made and funds returned to HUD because: HUD had approved their use of the funds; the Authority believed expenditures were appropriate; or the Authority was going to request a waiver from HUD. Specifically:

- The Authority said that HUD authorized it to spend \$795,958 from the sale of townhouses for other eligible public housing purposes.
- The Authority contended Section 108 funds totaling \$916,995 were included in the approved project budget as sources for the development of public housing units. Additional Section 108 funds were reserved for contingency expenditures. The Authority also said that all project funds were expended according to the ratios and procedures prescribed in the Grant Agreement with the exception of the mistake for expending Section 108 contingency funds prior to expending the HOPE VI funds.
- The Authority said it would submit a revised Total Development Cost waiver request to HUD that accounts for change orders totaling \$1,924,340 of the \$2,067,636.71 where the Authority exceeded HUD's approved amount. The Authority said that the change orders were issued as a result of unknown site conditions and that it would seek a waiver from HUD for the \$1,924,340.
- The Authority said that for the \$15,937 used to purchase a vehicle it would determine an amount to reimburse the HOPE VI Program. The amount would be based on the value of the vehicle after use in the HOPE VI Program for three years. With HUD's approval of the budget revision submitted in 2001, the purchase is eligible under HOPE VI.

OIG Evaluation of
Auditee Comments

The Authority's action to improve accounting for grant funds will improve the controls over the HOPE VI Program. Although the Authority addressed most of our initial recommendations in this area, some matters remain.

In addition, the Authority still needs to record appropriate transactions and return funds to HUD. Specifically, regarding:

- the \$795,958. Neither the Authority nor HUD could provide supporting documentation that HUD authorized the Authority to spend the funds for other purposes.
- the \$916,995. The Authority is incorrect in its conclusion that there was an approved project budget for Lafayette Courts. In fact, HUD never approved a budget for Lafayette Courts. Furthermore, in its Section 108 application, the Authority specifically notified HUD of its intent to spend in excess of \$8 million for public facilities and site improvements for Lafayette Courts. The application did not specify reserving amounts for contingency expenditures and specified other uses for the funds not specifically allocated to the redevelopment of Lafayette Courts.
- the \$2,067,637. The change orders totaling \$1,924,340 were not as a result of unknown site conditions. Rather the change orders were primarily for such items as furnishings, air conditioning, security, interior design services, and finished basements.
- the \$15,937 used to purchase a vehicle. Since HABC never used the vehicle for Lafayette Courts development purposes, the use of those funds in their entirety are an ineligible use of the Lafayette Courts Grant funds.

Recommendations

We recommend that you require the Authority to:

- 2A. Develop and implement procedures to improve accounting for grant funds. The procedures should include, but not be limited to, the following:
 - enter budgetary information into the accounting system, investigate variances, and take appropriate management action;

- provide HUD a full accounting of public housing funds that exceed total development costs at the completion of a development and return to HUD any public housing funds the Authority used in excess of the HUD approved amount;
 - properly account for petty cash (including maintaining a comprehensive list of petty cash custodians and transferring funds when custodians change);
 - report impaired loans in accordance with Generally Accepted Accounting Principles; and
 - require the Development Office to coordinate financing activities with the Chief Financial Officer.
- 2B. Record the \$795,958 from the sale of townhouses as program income to the Lafayette HOPE VI Revitalization Grant and return the funds to HUD so that HUD may make these funds available for needed revitalization projects.
- 2C. Repay the HOPE VI Account \$916,995 from non-Federal sources.
- 2D. Return the \$2,067,637 to HUD from non-Federal funds, for the public housing funds the Authority expended in excess of approved total development costs.
- 2E. Provide support for the use of the HOPE VI funds totaling \$15,937 to purchase a vehicle. If the Authority can not provide the support, direct HABC to repay the HOPE VI account that amount and return the unused funds to HUD.

The Authority Did Not Effectively Administer Its Community and Supportive Services Program

The Authority did not effectively administer its Community and Supportive Services (CSS) Program. Specifically, the Authority did not provide sufficient services to former residents of the revitalized developments and did not adequately monitor the CSS Program. These conditions occurred because the Authority did not establish the necessary procedures to properly administer its CSS Program. As a result, former residents of the HOPE VI sites did not receive the appropriate level of services that HUD intended and the Authority did not know if its HOPE VI goals and objectives were achieved or if proper controls were in place.

Background

The community service component of the HOPE VI grants is an integral part of the HOPE VI Program. Community service programs engage HOPE VI residents in meaningful service on a volunteer basis or through limited stipends. Examples of community service programs would be resident youths helping to repair and maintain units, and residents assisting the elderly or handicapped. Supportive services include all activities that will promote upward mobility, self-sufficiency, and improved quality of life for the residents of the public housing development involved, including literacy training, job training, day care, transportation, and economic development activities.

The Authority budgeted HOPE VI funds totaling \$12,423,032 to provide CSS at five developments. At the time of our review, the Authority had expended HOPE VI funds for Lafayette Courts and Lexington Terraces. The Authority had expended little, if any, on the remaining developments because the developments were in the process of construction or construction had not yet started.

The Authority took alternative approaches to providing CSS to former and current residents of the HOPE VI sites. The Authority administered the CSS Program for Lafayette Courts and contracted out the CSS Program for Lexington Terraces.

Criteria

OMB Circular A-133, Subpart C, Section .300 (b) requires the Authority to maintain internal control over its Federal programs that provides reasonable assurance that it is managing its Federal awards in compliance with laws, regulations and the provisions of Grant Agreements.

A. The Authority Did Not Provide Equivalent Services to Former Residents

The Authority did not provide the same level of CSS to former residents of the HOPE VI developments as it provided the residents of the revitalized developments. The Grant Agreements emphasized HUD's desire to address the needs of the people residing in the Lafayette Courts and Lexington Terraces developments. The Authority did not provide any documentation to explain why the former residents did not receive the same level of services as residents that relocated to the development after revitalization. Hence, we concluded that Authority did not place as high a priority on servicing these former residents as it did for residents that moved in after revitalization

Draft HOPE VI guidance dated February 18, 2000, states that the success of HOPE VI may ultimately be judged by its effectiveness that low-income families improve the quality of their lives and move toward self-sufficiency. The HOPE VI Program should offer appropriate services toward these ends to all families who reside in a development when the HOPE VI process begins, as well as needy families that move into the development after revitalization. These services should provide the tools to enable the residents to improve their life skills and capacities and secure living wage jobs and, when they choose to do so, to relocate to a new neighborhood of their choice.

All Eligible Residents Were Not Provided Support Services

The Authority, along with HUD, hired a consultant to provide technical assistance related to the administration of the Authority's HOPE VI Programs. The consultant's primary assignment was to evaluate the Authority's systems and processes and help resolve "big picture" issues to ensure residents received services that enabled them to become self-sufficient. In February 2001, the consultant noted that there were over 2,100 HOPE VI families and that about 300 residents elected not to participate in the program. Approximately 1,000 residents were in the

Authority's public housing properties and the remaining 800 residents were receiving Section 8 benefits.

The consultant estimated that of the 800 Section 8 families, 300 to 400 were not receiving case management. The consultant realized an even more problematic issue was the reliance on the public housing counselors to serve the residents in Authority properties. The Resident Services Director estimated there were about 100 to 150 residents per counselor at Authority properties and that in an ideal situation a counselor would not serve more than 50 families. The consultant concluded that given the sheer number of residents and the resident to counselor ratio, these services were primarily limited to referral services with no outreach and no case management and there were many opportunities for HOPE VI residents to "fall through the cracks."

We noted the Authority contracted for HOPE VI CSS support for the residents of Lexington Terraces. We reviewed the CSS contract and found that it did not require the CSS provider to provide a comparable level of services to former Lexington Terraces residents who did not relocate back to Lexington Terraces after revitalization. Although the CSS Administrator said the contractor did perform some services for the former residents that did not relocate to Lexington Terraces, the contractor's performance reports did not identify any of these former residents that received services. Further, the CSS Administrator could not provide any statistics on the number of former residents serviced by the CSS provider. Hence, we concluded that few, if any, former residents received services that were comparable to the services received by the current residents of Lexington Terraces.

B. The Authority Did Not Adequately Monitor Its HOPE VI CSS Program

The Authority did not adequately monitor its HOPE VI CSS Program to determine if the program achieved its goals and objectives and to determine if proper controls were in place. The Authority had not developed a system to monitor the program because they placed a low priority on the CSS Program. Grant Agreements required the Authority to monitor its programs to determine if they are

achieving the desired results. As a result, the Authority could not quantitatively determine the success of its program, did not detect that a contractor provided services to ineligible individuals, and did not ensure necessary controls were established to safeguard computers.

Good monitoring systems are essential to the effective management of any program attempting to provide self-sufficiency oriented services to low-income families. HUD encouraged local HOPE VI managers to develop monitoring systems that will meet their own needs. The purpose of our review was to determine if the Authority was monitoring its program, to ascertain if the Authority was achieving its objectives and if not, what corrective action the Authority was taking to achieve the objectives.

Managers Could Not Provide CSS Workplans

To initiate our review of CSS, we requested copies of the CSS Workplans. However, neither the Development Office nor the Resident Services Department could provide final versions of all the CSS Workplans nor could they always discern which was a draft and which was a final Workplan.

CSS Workplan Goals And Objectives Differed From Those In The CSS Provider Contract

We reviewed the available HOPE VI CSS Workplans and found the Authority identified goals and quantifiable objectives under its Workplans. We also noted the Authority took alternative approaches to providing CSS to the developments' residents. For example, the Authority administered the CSS Program for Lafayette Courts and contracted out the CSS Program for Lexington Terraces.

However, when we reviewed the contract for Lexington Terraces' CSS provider, we noted it contained goals and outcomes which differed from the goals and objectives contained in the CSS Workplan.

Monitoring System Not Developed

The CSS Workplans referred to a specific institution of higher learning that was to develop and implement a system for evaluating the success of the CSS Program. The Director said that although the Authority had not yet finalized an agreement with the institution, he was in the process of an ongoing dialogue with the institution to determine the various methods in which to capture the information needed to determine whether the Authority was achieving its objectives. The Authority's first CSS Workplan, dated March 1998, indicated there would be an

agreement with the institution, but at the time of our audit, there was still no agreement. Hence, we concluded the Authority did not provide sufficient management attention to developing a monitoring system.

Performance Was Not
Evaluated

The CSS Administrator and Associate Director of Resident Services said the Authority had not evaluated the performance of either the Lafayette Courts or Lexington Terraces CSS Programs to determine if the Authority was achieving its stated objectives. Hence, neither the Administrator nor the Director knew whether the CSS Program was successful based on the pre-defined objectives.

Some Residents Were
Dissatisfied

We discussed the CSS level of satisfaction with the Lafayette Courts and Lexington Terraces residents. Lafayette Courts residents said they were generally satisfied with the level of supportive services provided. However, Lexington Terraces residents informed us the contracted CSS provider did not furnish adequate computer related training and did not install computers in residences at an adequate rate. The Authority had tasked the CSS provider with establishing a computer-learning center, and installing computers in townhouses and a Senior Building.

We further discussed the performance of the CSS provider with the Resident Services Director. The director said prior managers paid little attention to oversight of the provider. Hence, the Authority missed the opportunity to redirect the provider's efforts. The Director also believed the CSS provider should have concentrated more on providing self-sufficiency training that would have enabled residents to enter the workforce and less on other forms of services.

Provider's Performance
Reports Were Deficient

The contracted CSS provider periodically supplied information relating to its success in meeting the goals and outcomes specified in the contract. However, the contractor's Final Performance Report, dated August 30, 2001, did not report on two goals and one outcome specified in the contract.

Excluding the two goals and one outcome the provider did not address, the contractor's final report summarized the CSS provider's success in achieving the goals and outcomes specified in the contract. However, we noted the report

contained obvious errors. Although the Administrator had a copy of the report, the Administrator was not aware of these errors, indicating the Administrator did not critically review the report. The Director said he had not seen the final report.

At our request, the CSS provider supplied schedules to support some of the progress claimed in the final report. Review of the reports and discussions with the CSS provider disclosed the provider:

- supplied training to individuals that were not former or current residents of the revitalized development or the surrounding community and therefore were not eligible to receive training paid for with HOPE VI funds;
- overstated the number of participants that found jobs; and,
- included children, attending summer camp and an after-school program, in statistics intended to reflect self-sufficiency achievements.

The Authority And
Provider Could Not
Account For Computers

The Authority did not ensure the Lexington Terraces CSS provider implemented controls to protect 189 computers from loss. Although prior managers took action to establish some responsibilities for oversight of the computers, the Authority's actions were insufficient and the provider did not implement the specified controls. As a result, 15 computers, valued at \$15,260, were either lost or misappropriated.

Title 24 CFR 85.20 requires that grantees maintain effective control and accountability for grant assets. Grantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

The CSS provider at Lexington Terraces was contractually required to operate the E-village. This entailed providing computer training to residents and providing them with computers. The provider installed computers in a computer lab and learning center, an elderly building, and townhouses. Residents were required to sign forms acknowledging they received the computers from the CSS provider.

Authority personnel did not know the number of computers purchased or where they could be located. The Authority's accountants and Resident Services Director did not know who was responsible for maintaining an inventory. Eventually, Development Office staff obtained a copy of an agreement from the owner of the rental townhouses. Authority staff said the agreement resulted from Authority management's efforts to ensure there were controls over the computers.

The agreement, between the owner and the CSS provider, required the provider to maintain detailed records and inventory lists of computer equipment and to assign an internal inventory number to each individual component when it received the computers. Also, the agreement required the CSS provider to provide insurance coverage for computers in storage and to promptly report incidents of theft or damaged equipment to the owner. However, the agreement did not require the CSS provider or the owner to conduct periodic inventories of the computers.

The contractor did not assign an internal inventory number to computers when it received the computers as required by the agreement. To account for the computers, we requested a listing of computers on-hand and the CSS provider supplied a list of 125 computers installed in townhouses. We sighted an additional 49 computers located in a computer lab and learning center, an elderly building, and an offsite storage facility. Hence, we were able to account for 174 (125 plus 49) computers. When compared to the 189 computers the provider billed the Authority, we found that the provider could not account for 15 computers valued at \$15,260.

Corrective Action Taken By The Auditee

During the audit, we notified the current Executive Director about the missing computers. He took appropriate action to find the computers and had the CSS provider replace computers that could not be found.

Auditee Comments

The Authority heartily endorses providing equivalent services for future displaced residents as well as equivalent services received by residents of the future revitalized developments. However, the Authority did not agree that it

was financially feasible absent a real commitment by the Federal government to fund its costs. The Authority believes that to provide a significantly reduced set of services to the residents of revitalized developments in order to provide the same level of services to displaced residents is unacceptable and questionably effective.

The Authority also agreed to develop and implement a system for monitoring the success of its HOPE VI Programs against the goals and objectives contained in the CSS Workplans.

OIG Evaluation of
Auditee Comments

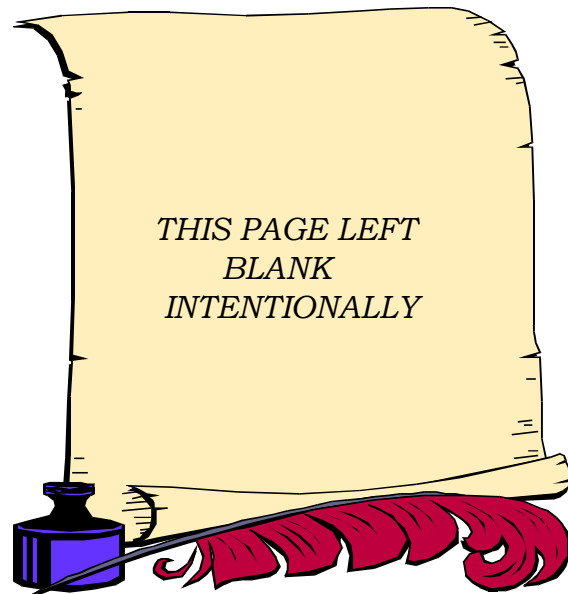
Generally, the Authority agreed with the recommendations.

Recommendations

We recommend you require the Authority to:

- 3A. Develop and implement a plan of action to ensure that former residents of HOPE VI developments, displaced in the future, are offered services that, at a minimum, are equivalent to services received by residents of revitalized developments.
- 3B. Develop and implement a system for monitoring the success of its HOPE VI Programs against the goals and objectives elaborated in the CSS Workplans and require managers to take appropriate action based on their monitoring efforts. This would include, but not be limited to, the following:
- Ensure that key managers have final versions of the HOPE VI CSS Workplans.
 - Ensure contracts awarded to CSS providers contain the same goals and objectives contained in the HOPE VI CSS Workplans.
 - Provide HOPE VI CSS only to eligible participants.

- Establish and implement additional procedures to safeguard the computers purchased for the E-Village. These controls should include procedures that require:
 - establishment of a memorandum ledger to account for the number and value of computers;
 - the CSS provider to provide periodic inventory listings, verified through physical inventories, to the Authority;
 - the Authority to compare the memorandum ledger to the inventory listings; and investigation of any discrepancies.



Management Controls

In planning and performing our audit, we considered the Authority's management controls 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 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 the following control processes were related to our audit objectives:

- Contracting processes including:
 - Analyzing and negotiating costs, fees, and terms
 - Soliciting and evaluating proposals
 - Contract administration
- Financial management processes including:
 - Requesting and monitoring HOPE VI funds
 - Initiating, approving, recording and monitoring transactions
- Community and Supportive Services:
 - Servicing residents
 - Monitoring results
 - Safeguarding assets

We assessed the relevant controls identified above.

A significant weakness exists 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 that significant weaknesses existed in all of the above-mentioned management control areas. In addition to the specific weaknesses discussed in the findings, we noted that the Authority's Internal Auditors were not permitted to exercise their oversight responsibilities. The Internal Auditors initiated audits of the HOPE VI activities in 1996, 1997, and 1998 but were unable to perform the audits because the HOPE VI Office thwarted them. Although the auditors said

they reported their difficulties to a former Deputy Executive Director (DED), the DED did not remove the impediments to enable them to perform audits of the development activities. Had the auditors been able to perform audits and if management implemented the auditors' recommendations, many of the deficiencies we noted might have been corrected. These auditors report to the Authority's Inspector General and he now reports to the Board instead of the Executive Director.

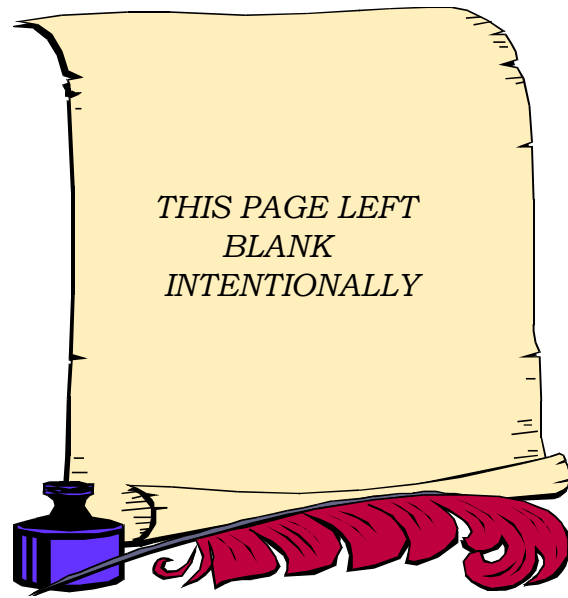
Follow Up On Prior Audits

This is the first audit by HUD's Office of Inspector General, specifically of the Authority's HOPE VI Program. However, the Office of Inspector General issued an audit report (98-FO-101-0001) on October 20, 1997 that did address some issues pertaining to the Authority's HOPE VI Program.

The OIG found that the Authority: (1) did not meet the minimum cost eligibility requirements for the Hollander Ridge effort; (2) did not include the community in the planning process; (3) awarded funds for construction for the application that lacked the appropriate narrative and/or certification as required by the NOFA; and (4) the planned revitalization efforts were not cost effective. That OIG recommended that HUD rescind the HOPE VI grant for Hollander Ridge. HUD disagreed with the recommendation and replied that it was premature to take any action until the Authority had the opportunity to prepare and submit a revitalization plan. HUD also pointed out that HOPE VI would permit a grantee to demolish a targeted site and construct replacement housing on another more viable site.

The Authority submitted plans to HUD to reuse the funds but HUD found the plans unsuitable. On April 18, 2001, the Acting General Deputy Assistant Secretary for Public and Indian Housing informed the Authority that the Department was recapturing the remaining grant funds totaling \$19,354,417.44. However, on August 2, 2001 the Senate amended the FY 2002 appropriations bill and allowed the Authority to use the remaining balance of the grant "...for the rehabilitation of the Claremont Homes project and for the provision of affordable housing in areas within the City of Baltimore either (1) designated by the partial consent decree in *Thompson v. HUD* as nonimpacted census tracts or (2) designated by said authority as either strong neighborhoods experiencing private investment or dynamic growth areas where public and/or private commercial or residential investment is occurring."

The single audit reports for the Authority for 1999 and 2000 did not contain findings related to the Authority's HOPE VI Program.

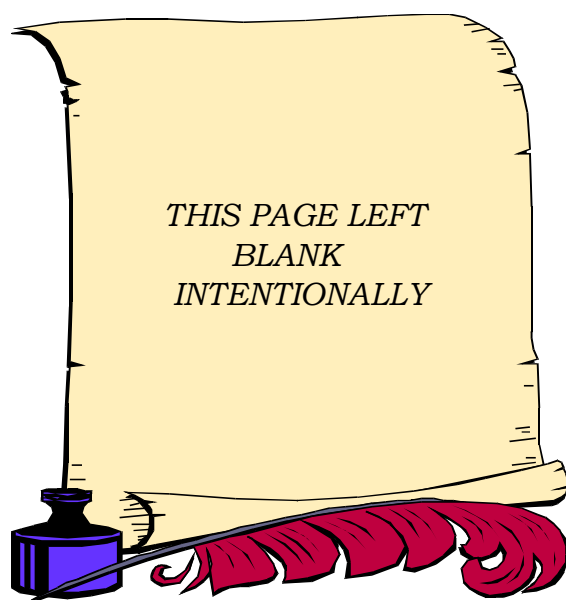


Schedule of Questioned Costs and Funds Put to Better Use

<u>Recommendation Number</u>	<u>Type of Questioned Cost</u>		<u>Funds Put to Better Use 3/</u>
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	
2B			\$795,958
2C			\$916,995
2D	\$2,067,637		
2E		\$15,937	
Total	\$2,067,637	\$15,937	\$1,712,953

Questioned costs include ineligible costs and unsupported costs.

- 1/ Ineligible costs are those that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement or other agreement or document governing the use of funds, or are otherwise prohibited.
- 2/ Unsupported costs are those whose eligibility or reasonableness cannot be clearly determined during the audit since they were not supported by adequate documentation or due to other circumstances. Under Federal cost principles, a cost must be adequately supported to be eligible.
- 3/ Funds put to better use are monetary savings resulting from management actions, in response to OIG recommendations, that prevent improper obligations or expenditures of agency funds or avoid unnecessary expenditures. The following categories of future monetary savings are funds put to better use: reductions in outlays; de-obligation of funds from programs or operations; withdrawal of interest; loans and guarantees not made; costs not incurred; avoidance of unnecessary expenditures; and other savings.



Auditee Comments

CITY OF BALTIMORE

MARTIN O'MALLEY, Mayor



HOUSING AUTHORITY OF BALTIMORE CITY

PAUL T. GRAZIANO, EXECUTIVE DIRECTOR
Lyle Schumann, Deputy Executive Director

417 East Fayette Street
P.O. Box 1917
Baltimore, MD 21202-3134

August 6, 2003

Mr. Daniel G. Temme
Regional Inspector General for Audit, Mid-Atlantic, 3AGA
U.S. Department of Housing and Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Dear Mr. Temme:

I have reviewed the draft audit report of the Housing Authority of Baltimore City's (HABC) HOPE VI Program. Enclosed please find the Authority's written comments to the findings and recommendations identified in the report. I appreciated meeting with you and the appropriate HUD officials in early June, to discuss the draft audit report in detail and to provide suggested revisions.

Please contact me at (410) 396-8050 should you have any questions or concerns regarding this matter. We will continue to keep you apprised of the progress made in the HABC HOPE VI Program.

Sincerely,



Paul T. Graziano
Executive Director

Enclosure



General Comments

The Draft Audit Report asserts on page iii, page 9, page 10, and page 14 that the HABC spent dramatically more funds than necessary on two developments, Lexington and Lafayette, funds which could have been used to create quality housing for hundreds of more families. The Report notes only in passing - a footnote on page iii - that HABC was authorized by HUD to make these expenditures. HABC requests that a more accurate portrayal of the facts on this issue be presented in the final report.

The HUD Total Development Cost (TDC) process in effect at the time of the Lafayette (1994) and Lexington (1995) HOPE VI grants was derived from the public housing industry's experience with the modernization of existing public housing sites. It was thus inappropriate and unworkable for the HOPE VI program, which contemplated the wholesale demolition and redevelopment of complex urban neighborhoods. HUD recognized this problem by consistently granting waivers or exceptions from the TDC limits in these grant years, and by totally revamping the TDC process - and significantly raising the TDC limits - in the 1999 grant year. HABC made the expenditures necessary to meet the real-world requirements of redeveloping the distressed urban sites that were Lafayette and Lexington, and did so with HUD authorization. In contrast to the assertions in this Draft Audit Report, if HABC were not to have made these full expenditures, the Lafayette and Lexington projects would not have been completed, or would have been only partially completed, to the significant detriment of the hundreds of public housing residents who are now enjoying safe and productive lives in these neighborhoods.

Recommendation - Finding 2A

Develop and implement procedures to improve accounting for grant funds.

Response - Finding 2A

The Authority updated the grant funds payment review procedures in 2002. Many changes were made to incorporate the addition of the HOPE VI program element and the increased information from that program that must be scrutinized. Attached in Exhibit A are detailed procedures that document LOCCS drawdown, Contract Payment Review and Reconciliation procedures. Specifically, Exhibit A, Section II, discusses Contract Payment Review that covers the Capital Fund and the HOPE VI programs. Accountants in Fiscal and staff in the Development Division work very closely together on a continual basis to ensure that all aspects of the program and its payments are reviewed and adequately recorded.

In accordance with each of the bulleted recommendations in the audit report, the Authority has taken the following specific corrective actions:

- Accounting staff has developed and now maintains detailed subsidiary ledgers depicting expenditure activity as charged to the general ledger. The corresponding

budgets, as supplied by the HOPE VI office, for these expenditures were also assigned, by account major, as a tool for monitoring program costs. As activity increased and unique HOPE VI issues prevailed, individual spreadsheets and review procedures were modified to encompass these elements and strengthen accounting controls. Closer attention is given to ensure that the supporting details accurately correspond to the account being charged. Reconciliations are routinely shared between Development and Accounting staff and discrepancies are resolved. Also, the Budget Division works closely with the Capital Program/HOPE VI Staff to ensure accurate monitoring of the program budget.

- The Authority will follow proper procedures to provide HUD a full accounting of public housing funds, in accordance with the Office of Public Housing Investments Grant Implementation Guidebook issued by HUD for HOPE VI. Specific documentation includes Total Development Costs and closeout certification. The Authority also ensures that Total Development Costs do not exceed the HUD approved amount.
- The Authority follows a Revised Procurement Policy adopted by the Board on May 20, 2003. The Revised Procurement Policy, Section III, A 1, discusses the policy for petty cash purchases (see Exhibit I for detail). The Authority Fiscal Department maintains a listing of petty cash custodians. See Exhibit B2 for a current listing of the Petty Cash custodians by development. Routine reconciliation of petty cash accounts occur.
- The Authority recognizes the complexity of the HOPE VI development program. The Fiscal Department hired an outside consulting firm to correct the development transactions prior to the FY 2002 closing. Specifically, the loan transactions have been corrected and the independent auditor has attested to the accuracy of the transactions during the FY 2002 independent audit. Further training will be provided to Accounting staff in order to stay abreast of the many issues of concern that are unique to this program.
- The Development Office works closely with the Chief Financial Officer to coordinate financing activities. The two offices monitor the program closely, transactions are reviewed via the HOPE VI Monthly Performance Report that provides a summary of all sources and uses for existing programs in various stages (see Exhibit B1).

Recommendation - Finding 2B

Record \$795,958 as program income and return the funds to HUD.

Response - Finding 2B

The Authority has properly received and appropriately recorded the \$795,958 from the sale of townhouses as program income to the Lafayette HOPE VI Revitalization Grant.

Exhibit C provides detailed documentation that this transaction was recorded appropriately.

The auditor is correct that program income such as that identified above must be used for current program costs unless the Federal agency authorizes otherwise. The program income identified above was realized subsequent to the completion of grant activities (but prior to the closeout of the grant), and thus could not be used for current program costs. HABC is authorized by HUD to utilize this program income for other eligible public housing purposes, as is customary with HOPE VI Grant Agreements.

Recommendation - Finding 2C

Repay HOPE VI \$916,995 from non-Federal sources.

Response - Finding 2C

The auditor is correct that the Grant Agreement requires the expenditure of grant funds be made only for eligible costs and only to the extent that other sources of funds are not available for payment of such project costs. The auditor is incorrect to conclude that the Section 108 source in question was available for payment of such project costs. HOPE VI grant funds and other funds, including a portion of the Section 108 funds, were included in the approved project budget as sources for the development of public housing units. Additional Section 108 funds, including those identified above, were reserved for contingency expenditures. By definition, and consistent with the Grant Agreement and approved project budget, the Section 108 contingency funds are intended to be expended last, and the nature of the contingency expenditure anticipates the type of transfers that occurred at the end of this project.

All project funds were expended according to the ratios and procedures prescribed in the Grant Agreement except for the specific mistake of expending Section 108 contingency funds prior to expending the full HOPE VI development fund. The HABC corrected this mistake prior to close-out of the grant. The Lafayette Courts Section 108 and HOPE VI account transfers were completed as of December 2001. The Authority returned to the City of Baltimore a net reduction in Section 108 expenditures in the amount of \$916,995.14 with HABC check RF#1124281 dated 5/10/02. See Exhibit D for a copy of the cancelled check and support for detail.

Recommendation - Finding 2D

Return the \$2,067,637 to HUD for public housing funds in excess of approved TDC.

Response - Finding 2D

The HUD Total Development Cost (TDC) process in effect at the time of the Lafayette (1994) and Lexington (1995) HOPE VI grants was derived from the public housing

industry's experience with the modernization of existing public housing sites. It was thus inappropriate and unworkable for the HOPE VI program, which contemplated the wholesale demolition and redevelopment of complex urban neighborhoods. HUD recognized this problem by consistently granting waivers or exceptions from the TDC limits in these grant years, and by totally revamping the TDC process - and significantly raising the TDC limits - in the 1999 grant year.

The original process required a grantee to seek a waiver or exception at the beginning of the approval review process based on initial cost estimates. The estimates were, by definition, inexact and could not fully accommodate all unforeseen conditions. HABC sought and received TDC waivers for these two projects that were appropriate to the conditions known or anticipated at the beginning of the respective projects.

The Authority records show that a total of \$2,067,636.71 was primarily related to unexpected and unforeseen change orders for conditions that could not have been identified when the original TDC waiver was sought in August 1996. Additional sources of income such as the Comprehensive Grant Program were utilized to cover this excess in TDC (see Exhibit E1). Based on the cost analysis, change orders in the amount of \$1,924,340.00 exceeded the original A&R/Harkins contract award amount of \$52,300,000 by slightly over 3% (see Exhibit E2), less than the industry norm for contingencies of 5-10% of the contract price.

In the case of Lafayette Courts, these contingencies were the direct result of unknown site conditions. It was discovered that prior to the high-rises being built, town homes occupied the site and when they were demolished, basements were merely filled in and concrete slabs placed over them. As excavation began for the new Pleasant View Gardens, the discovery was made and extensive work was needed to remove the old footings, foundations, etc.

HABC will submit a revised TDC waiver request to HUD that accounts for all of the unforeseen condition costs identified above.

Recommendation - Finding 2E

Provide support of \$15,937 from HOPE VI to purchase a vehicle.

Response - Finding 2E

The HOPE VI department submitted a Lafayette Courts budget revision in December 2001 to the Regional HUD office that included the vehicle purchase in question (see Exhibit F). At that time, the Authority was informed that the budget would not be approved pending the conclusion of the OIG audit. The vehicle was justifiably purchased with HOPE VI funds as it was used to shuttle numerous residents displaced after the Lafayette Courts demolition and in search of shelter to view various Section 8 sites for relocation. With HUD's approval of the budget revision submitted in 2001, the purchase is eligible under HOPE VI.

The HABC Section 8 program is currently using the subject vehicle for their relocation activities. HABC will dispose of the subject vehicle to the Section 8 program in the following manner: HABC will establish the prevailing three year lease cost for a comparable vehicle corresponding to the three years in which the vehicle was used for HOPE VI purposes, deduct that cost from the purchase price, charge the Section 8 program that difference, and reimburse the HOPE VI program in the amount of that difference.

Section 2 EXHIBITS:

A. *Procedures Listing*

B1. *HOPE VI Monthly Performance Report*

B2. *Accounts Payable Listing of Petty Cash Custodians*

C. *Lafayette Program Income JV*

D. *Lafayette - Section 108 JV*

E1. *Sources and Uses - Lafayette spreadsheet (provided by Development staff)*

E2. *A&R/Harkins Contract Ledger*

F. *Accounts Payable Records for Purchase of Vehicle*

I. *Revised Procurement Policy*

Recommendation - Finding 3A

Develop and implement a plan of action to ensure that former residents of HOPE VI developments, displaced in the future, are offered services that, at a minimum, are equivalent to services received by residents of revitalized developments.

Response - Finding 3A

It is true that in 2000 HUD began to publicly discuss the need to provide comparable levels of C&SS program support to all original residents at HOPE VI sites, and that HUD issued "Draft Guidance" at that time. The Lafayette and Lexington Terrace HOPE VI grants, however, were awarded in 1994 and 1995 respectively. The HOPE VI grant applications, revitalization plans, and C&SS plans were each submitted and approved well prior to the issuance of the "Draft HOPE VI Guidance" referenced above and in the Draft IG Audit. The 1994 and 1995 HUD/VA Appropriations Acts, the 1994 and 1995 HOPE VI Demonstration Notices, and the Grant Agreements between HUD and the HABC for the respective projects (MD06URD002I194 and MD06URD002I195) are all silent on this issue. HABC could find no statutory, regulatory, contractual or policy requirement that the 1994 and 1995 HOPE VI grantees provide levels of C&SS program support to non-returning residents comparable to that provided to returning residents.

Beyond the lack of statutory, regulatory, contractual, or policy authority to require comparable levels of services to these two populations, the public housing program generally and the HOPE VI grant specifically are insufficiently funded for such a massive undertaking. In the example raised in the draft audit report (page 37), if the HABC were to have provided comprehensive case management services to the entire population of 2,100 families originally resident at the Lafayette and Lexington HOPE VI sites, at the level of service implied by the criticism in the report (50 families per caseworker), the total C&SS program budget for these two sites (\$5,455,000) would have been exhausted on this single activity in approximately 21 months - well prior to the completion of the units - and no other services could have been provided¹. The unacceptable and questionably effective alternative would have been to provide a significantly reduced set of services, within the permissible budget, to all residents. The recommendation #3A to develop and implement a plan to ensure that former residents of HOPE VI developments, displaced in the future, are offered services that are equivalent to services received by residents of revitalized developments is one that the HABC heartily endorses. It is also one that is not financially feasible absent a real commitment by the federal government to fund its costs. The HABC has never been funded sufficiently by HUD to provide the level of service recommended by the audit report.

¹ Assume 2,100 families @ 50 families per caseworker = 42 caseworkers; x \$75,000 per case worker for salary, benefits, supplies, management supervision, office space, overhead, administration, etc. = \$3,150,000 program expense per year. Assume further a caseworker with an MSW and 5 years experience @\$40,000 per year; 40% benefit rate or \$16,000 per year; 2 supervisory FTE's @\$55,000 per year plus \$22,000 benefits pro rated at \$3,700 per each of 42 case workers; office space and supplies @\$4,000 per year per caseworker; 20% HABC administration and overhead @ \$12,750 per year; totals \$76,440, say \$75,000.

Recommendation - Finding 3B

Develop and implement a system for monitoring the success of its HOPE VI Programs against the goals and objectives elaborated in the CSS Workplans and require managers to take appropriate action based on their monitoring efforts.

Response - Finding 3B

The current HABC Administration views HOPE VI C&SS as essential to the overall success of the HOPE VI program and participant families, and has made significant improvements to the administration of the program. As previously discussed with the audit staff at the exit conference but not referenced in this report, HABC has already taken corrective action in this matter. HABC has assigned an experienced program administrator to be solely responsible for all aspects of the HOPE VI CSS program administration. This administrator has clarified and circulated to all appropriate parties the approved CSS work plans for each site; has identified discrepancies among work plan goals and service contract deliverables, and is currently engaged in amending service contracts to conform with the approved work plans; will develop and implement monitoring and evaluation protocols for each site; and will ensure that all project documentation is complete and readily available.