Issue Date July 29, 2005
Audit Report Number 2005-PH-1013

TO: Nadab Bynum, Director, Office of Community Planning and Development, Philadelphia Regional Office, 3AD

FROM: Daniel G. Temme, Regional Inspector General for Audit, Philadelphia Regional Office, 3AGA

SUBJECT: Review of the Commonwealth of Pennsylvania's HOME Investment Partnership Program, Harrisburg, Pennsylvania

HIGHLIGHTS

What We Audited and Why

In response to a request from the former assistant United States attorney of the Commonwealth of Pennsylvania, we audited Pennsylvania's Department of Community and Economic Development's (Commonwealth) administration of the HOME Investment Partnership Program (HOME). Our audit objectives were to determine whether the Commonwealth is 1) adequately monitoring localities to ensure HOME funds are expended on allowable HOME activities, and 2) properly allocating its staff's time for the administration of the HOME program in accordance with applicable U.S. Department of Housing and Urban Development (HUD) and other federal regulations.

What We Found

The Commonwealth is not adequately monitoring its localities to ensure HOME funds are expended on eligible HOME activities and is improperly allocating its staff's time for the administration of the HOME program. Three of the four localities we reviewed had spent a portion of their HOME funds on ineligible expenses/activities, which totaled $79,070. This occurred because the Commonwealth did not develop or implement an adequate monitoring program to oversee its localities. The Commonwealth had accumulated more than $6.9 million in administrative fees from the program by obligating more funds than it spent to administer its HOME program. These excess funds should have been used to strengthen the Commonwealth's monitoring program and to fund additional eligible HOME projects. Doing so would have enabled the Commonwealth's HOME program to better meet its main goal of providing affordable housing for low-income households.

In addition, we found the Commonwealth is improperly allocating its staff's time for the administration of the HOME program. Instead of maintaining accurate timesheets, the Commonwealth follows an unwritten policy that requires staff time to be split equally between the HOME and Community Development Block Grant (Block Grant) programs. As a result, the Commonwealth is unable to ensure HOME funds are only being used to pay for the administration of the HOME program.

What We Recommend

We recommend that the director of Community Planning and Development, Philadelphia Regional Office, require the Commonwealth to recover $79,070 in ineligible fees from the localities we reviewed. In addition, the Commonwealth should use the accumulated $6,930,916 in administrative fees to improve its monitoring program and recommit the funds to eligible HOME projects. We also recommend that the director of Community Planning and Development, Philadelphia Regional Office, require the Commonwealth to establish proper time allocations that meet the requirements of Office of Management and Budget Circular A-87.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

The complete text of the Commonwealth's response, along with our evaluation of that response, can be found in Appendix B of this report.

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BACKGROUND AND OBJECTIVES

The HOME Investment Partnership Program (HOME) is authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended, and is regulated by *Code of Federal Regulations,* title 24, part 92. HOME is the largest federal block grant provided to state and local governments and is designed to create affordable housing for low-income households. HOME funds are awarded annually as formula grants to participating jurisdictions. State governments are automatically eligible for HOME funds and receive either the greater of $3 million or the amount calculated under their formula allocation. Participating jurisdictions may choose among a broad range of eligible activities using HOME funds. These activities may include providing home purchase or rehabilitation financing assistance to eligible homebuyers, building or rehabilitating housing for rent or ownership, or obtaining property to make way for HOME-assisted developments.

As a participating jurisdiction, the Commonwealth of Pennsylvania administers its HOME program through the Department of Community and Economic Development (Commonwealth). The Commonwealth received $92,228,850 in HOME grants from the U.S. Department of Housing and Urban Development (HUD) over a three-year period.

Grant Year	Grant Amount
2002	$28,828,000
2003	$30,165,304
2004	$33,235,546
Total	**$92,228,850**

Of these funds, the Commonwealth awarded at least 33.3 percent for each of these years to the Pennsylvania Housing Finance Agency. An additional 10 percent was obligated to the Commonwealth for administrative costs. The remaining HOME funds were then awarded to approximately forty-five local governments each grant year in amounts ranging from $5,000 to $550,000.

In early 2002, a suit was filed by a former Commonwealth employee, along with the United States of America, acting on behalf of HUD, against the Commonwealth. The suit claimed the Commonwealth falsely charged time to the HOME program for employees having no relationship with the program. A full and final settlement was reached between the Commonwealth and the United States of America in early 2002. As a result, the Commonwealth agreed to pay the United States $1,696,000 in damages.

Our overall objective was to determine whether the Commonwealth is properly administering its HOME program by 1) adequately monitoring localities to ensure HOME funds are expended on allowable HOME activities, and 2) properly allocating its staff's time for the administration of the HOME program in accordance with applicable HUD and other federal regulations.

RESULTS OF AUDIT

Finding 1: The Commonwealth Does Not Ensure HOME Funds Are Expended on Eligible HOME Activities

The Commonwealth is not adequately monitoring its localities to ensure HOME funds are expended on eligible HOME activities. Three of the four localities we reviewed violated some provision of the HOME requirements. The Commonwealth failed to ensure

- A nonprofit entity operating as a community housing development organization was set up properly,
- An operating budget contained only eligible operating expenses, and
- Program income was used only for eligible activities.

This occurred because the Commonwealth did not develop or implement an adequate monitoring program to oversee its localities. As a result, the three localities spent $79,070 of their HOME funds on ineligible expenses/activities that the Commonwealth did not detect. The Commonwealth had accumulated more than $6.9 million in administrative fees from the program by obligating more funds than it spent to administer its HOME program. These excess funds should have been used to strengthen the Commonwealth's monitoring program and to fund additional eligible HOME projects. Doing so would have enabled the Commonwealth's HOME program to better meet its main goal of providing affordable housing for low-income households.

HOME Funds Were Not Always Spent on Eligible Activities

In three of the four localities we reviewed, the Commonwealth failed to ensure HOME funds were expended only on eligible HOME activities. Our review focused on HOME grants provided during 2002, 2003, and 2004 to the following localities: Carlisle Borough, Franklin County, Monroe County, and Lebanon County. During our review, we wanted to determine whether the HOME funds provided to each locality were expended on eligible HOME activities. The detailed results of our review follow.

Franklin County

Mid-Atlantic Coalition Was Not Properly Set Up as a Community Housing Development Organization

The Mid-Atlantic Coalition for Housing Opportunities (Mid-Atlantic) violated federal HOME regulations in operating as a community housing development organization. Mid-Atlantic's financial advisor plans Mid-Atlantic's HOME-funded projects, which are then awarded to a for-profit construction firm (G. Keith Construction) in which the financial advisor is the owner. *Code of Federal Regulations*, title 24, part 92.2 defines a community housing development organization as "a private nonprofit organization that is neither controlled by, nor under the direction of, individuals or entities seeking to derive profit or gain from the organization." Thus, by the owner of the for-profit construction company also serving as Mid-Atlantic's financial advisor, there is no assurance that Mid-Atlantic is not being controlled by an individual who seeks to gain a profit from the organization.

Furthermore, Mid-Atlantic's executive secretary prepares and signs checks for both Mid-Atlantic and G. Keith Construction. In 1996, Mid-Atlantic's board gave its executive secretary the authority to supervise and direct the management and operation of the corporation. In 1997, Mid-Atlantic's executive secretary signed a power of attorney in which G. Keith Construction appointed her as attorney-in-fact to deposit or withdraw funds held in G. Keith Construction's account. Thus, Mid-Atlantic's executive secretary is also acting as an agent for G. Keith Construction, which is a violation of the regulation.

Monroe County

Sub-recipient Included Ineligible Expenses in Its Operating Budget to Obtain a Larger Grant Than It Was Eligible

The Commonwealth failed to identify ineligible operating expenses on the Shepherds of Monroe County's (Shepherds) 2004 operating budget, which allowed the Shepherds to receive a higher operating grant in 2004. The Shepherds' operating budget contained a $16,000 interest expense, incurred on the payment of the loan used to purchase land for the Shepherds' future HOME-funded project. *Code of Federal Regulations*, title 24, part 92.206(g) classifies costs relating to the payment of loans, including interest for such loans, as a project cost. Therefore, the $16,000 is an ineligible operating expense and should not have been included in the operating budget. In addition, the Shepherds optimistically budgeted the executive director's salary as $55,000, which includes potential bonuses offered to the executive director as an incentive to obtain grants from local vendors. However, the Commonwealth did not review the actual year-end operating expenses showing the executive director's salary was only $32,666 in 2004.

Code of Federal Regulations, title 24, part 92.300(f) states a certified community housing development organization is allowed an operating grant between the greater of $50,000 or 50 percent of its operating budget. Shepherds received its 2004 operating grant of $75,000 based upon an operating budget of $150,420, which included the ineligible operating expense of $16,000 and an over-inflated executive director's salary by $22,334. As a result, Shepherds overstated its operating budget by $38,334 and received $18,957 in additional HOME funds.[1]

Lebanon County

Lebanon County Redevelopment Authority Improperly Spent Program Income

From June 2003 through January 2005, the Lebanon County Redevelopment Authority (Authority) improperly spent $60,113 of $262,448 (23 percent) in program income on administrative costs. *Code of Federal Regulations*, title 24, part 92.503(a) allows the Authority to retain program income for additional HOME-eligible projects pursuant to the Authority's contract with the Commonwealth. However, appendix C, (2)(j), of the Commonwealth's HOME contract with the Authority directly prohibits the use of program income for administrative costs. Therefore, the Authority violated the Commonwealth's program income provisions.

The Commonwealth Did Not Develop and Implement an Adequate Monitoring Program

The Commonwealth was not able to identify violations of HOME and/or Commonwealth regulations because it did not develop and implement an adequate monitoring program. The Commonwealth conducts infrequent and limited monitoring visits of its grantees, has minimal staff, and is not fully using $6,930,916 in obligated administrative fees to ensure current monitoring procedures are effective.

The Commonwealth Performs Infrequent and Limited Monitoring Reviews of Its Grantees

Code of Federal Regulations, title 24, part 92.201 provides the Commonwealth must conduct reviews and audits of its State Recipients as may be necessary to determine whether the State Recipient has met the HOME regulations. Our review of the Commonwealth showed that the Commonwealth did not always

[1] Adjusted operating budget of $112,086 (reduced by $38,334 to account for over-inflated salary of $22,334 and $16,000 in ineligible interest expense) times .50 = $56,043. Adjusted grant amount was calculated by subtracting $56,043 from the $75,000 amount that was received.

complete adequate monitoring reviews. For example, the Commonwealth failed to perform any form of a monitoring review of Monroe County during the four-year period of 2001 through 2004. For the remaining three localities we reviewed, it performed reviews for Carlisle Borough in August 2003, Franklin County in September 2002, and Lebanon County in April 2003. The review of Lebanon County was performed for Community Development Block Grant (Block Grant) and/or HOME funds received in 1999, 2000, and 2001. The review of Franklin County was performed for HOME funds received in 2000 and 2001, and the review of Carlisle Borough was performed for HOME funds received in 2002.

The Commonwealth Relies on Self-Assessments By Its Grantees

When the Commonwealth does conduct reviews, they are largely based on a self-assessment by the locality. The Commonwealth sends the locality a self-assessment checklist it is requested to complete. This information is then verified during the onsite monitoring visit. However, the questions on the checklist are general in nature and have limited coverage concerning the eligibility of the costs related to the HOME program. Further, our review of the monitoring reviews of Carlisle Borough, Franklin County, and Lebanon County gave no indication the grant managers verified the information provided to them on the checklists. The Commonwealth also did not maintain documentation to support or verify the answers given by the localities. When we discussed these issues with the Commonwealth’s division chief, he explained his staff are not experts in the HOME program and do not have the expertise needed to identify many of the issues we identified from our reviews.

The Commonwealth Does Not Employ Sufficient Staff to Effectively Administer Its HOME Program

The Commonwealth does not have sufficient staff to administer its HOME program effectively. The Commonwealth currently has five grant managers who administer and monitor the HOME, Block Grant, and Emergency Shelter Grant programs for sixty-seven local governments. Commonwealth employees informed us that on average there are 125-150 Block Grants and 35-40 HOME grants issued in a year. Each grant manager is assigned from twelve to sixteen local governments to manage. Their responsibilities include reviewing grant applications to ensure compliance and completeness, addressing questions and/or concerns of the local governments, and monitoring each local government to ensure HOME funds are expended on allowable activities.

The Commonwealth is Not Fully Utilizing Its Obligated Administrative Fees

Since 2001, the Commonwealth has obligated $6,930,916 in HOME funds for administrative fees in excess of its actual operating expenses. The following table shows the amount of administrative fees the Commonwealth over-obligated from the HOME program for grant years 2001 through 2005.

Accumulated Administrative Fees		
Grant Year	**Amount Obligated**	**Amount Used**
2001	$1,428,362	$0.00
2002	$1,544,915	$0.00
2003	$1,518,652	$0.00
2004	$1,273,204	$0.00
2005	$1,165,783	$0.00
Total	**$6,930,916**	**$0**

Although the Commonwealth obligated between $1.17 million and $1.54 million each year for administrative fees, it only expended between $570,000[2] and $772,487 of the obligated amounts each year. The following table shows the amount of administrative fees drawn by the Commonwealth from 2002 through 2004, as well as the grant years the funds were drawn from.

Grant Year Drawn From	Calendar Year in Which Administrative Fees Were Drawn		
	2002	**2003**	**2004**
1995	$ 3,500	$0	$0
1996	$ 3,025	$0	$0
1997	$ 14,568	$0	$0
1998	$278,848	$0	$0
1999	$472,546	$635,000	$172,280
2000	$0	$0	$397,720
Totals	**$772,487**	**$635,000**	**$570,000**

As the table above shows, the Commonwealth started drawing administrative fees from the 2000 HOME grant in 2004. As of May 2005, the Commonwealth had $775,454 in obligated funds remaining from the 2000 HOME grant for administrative fees. Based on the Commonwealth's history of administrative fee

[2] The data for the 2004 administrative draws were provided to HUD's Office of Inspector General on December 21, 2004; therefore, the $570,000 does not include any draws made from December 21 through December 31, 2004.

expenditures, the remaining portion of the 2000 grant should be sufficient to cover the Commonwealth's remaining 2005 administrative expenses.

As discussed above, the Commonwealth has accumulated $6,930,916 in excess administrative fees that could be used to strengthen its inadequate monitoring program. In addition, these excess obligations could be used to fund other eligible HOME projects. Therefore, any funds the Commonwealth does not use to strengthen its monitoring program should be reprogrammed for the use of HOME-eligible projects. This would help the Commonwealth ensure the HOME program's main goal of providing affordable housing for low-income households is accomplished more efficiently.

Recommendations

We recommend that the Philadelphia Regional Office of Community Planning and Development

1A. Ensure the Commonwealth recovers the $18,957 in ineligible HOME funds from Monroe County.

1B. Ensure the Commonwealth recovers the $60,113 in ineligible HOME funds from Lebanon County.

1C. Determine whether Mid-Atlantic violated either provision (3) under the *Code of Federal Regulations*, title 24, part 92.2 definition of a community housing development organization or the HOME conflict of interest provisions. If Mid-Atlantic violated either of these provisions, seek administrative actions against Mid-Atlantic's financial advisor and owner of G. Keith Construction.

1D. Determine whether the Commonwealth should be allowed to continue on-site monitoring of HOME program recipients on a three-year schedule. If this schedule continues to be allowed, require the Commonwealth to establish procedures that ensure the Commonwealth reviews, at least annually, financial reports (i.e., income statement, balance sheet, general ledgers, etc.) submitted by the sub-recipients and/or contractors to ensure HOME funds are being expended on eligible activities.

1E. Require the Commonwealth to improve its monitoring procedures to include (at a minimum)

i. A more comprehensive review checklist,
ii. Procedures to ensure HOME funds expended (i.e., developer fees, project costs, operating costs, etc.) are valid HOME program activities, and

iii. Documentation stating the specific information and/or documentation used by the grant managers to verify the monitoring checklist and to complete their reviews.

1F. Require the Commonwealth to employ and/or contract additional staff to ensure its monitoring process is efficient, adequate, and in compliance with the HOME regulations.

1G. Ensure current and future Commonwealth employees receive HOME-specific training that will provide them the expertise required to effectively administer and monitor the HOME program.

1H. Require the Commonwealth to establish a procedure (on an annual basis) that will ensure future funds obligated by the Commonwealth for administrative fees are based on actual administrative costs. This procedure should ensure that any amount the Commonwealth determines is in excess of the actual expenditures should be recommitted for use on eligible HOME projects.

1I. Require the Commonwealth to recommit any portion of the $6,930,916 not used by the Commonwealth to strengthen its monitoring program for use on HOME-eligible projects.

1J. Determine if the procedures implemented by the Commonwealth are sufficient to adequately monitor its HOME program. If the Commonwealth fails to implement these procedures, seek appropriate administrative actions as described in *Code of Federal Regulations*, title 24, part 92.

Finding 2: The Commonwealth Is Improperly Allocating Staff Time to Its HOME and Block Grant Programs

The Commonwealth is improperly allocating its staff's time to the HOME and Block Grant programs. The Commonwealth has an unwritten policy that its staff's time is to be equally divided between the HOME and Block Grant programs. As a result, the Commonwealth's staff created timesheets to reflect this unwritten policy. Consequently, the Commonwealth is unable to ensure that approximately $660,000[3] in HOME funds spent annually on administrative fees is not expended on the administration of the Block Grant program. Also, the Commonwealth is unable to ensure it is complying with the maximum regulatory amounts of HOME and/or Block Grant funding allowed for the administration of each corresponding program.

The Commonwealth Has an Unwritten Time Allocation Policy

Based on the Commonwealth's unwritten time allocation policy, seven Commonwealth employees signed annual time allocation certifications, stating 50 percent of their time is devoted to each of the HOME and Block Grant programs. However, our review found this was not always the case. When we spoke to the individual employees, we found that one employee spends approximately six months of each year solely on HUD's McKinney Act program. In two other examples, employees stated they spend approximately 70-80 percent of their time working on the Block Grant program. However, all of their time was divided equally between the HOME and Block Grant programs. When we asked the employees why the time was split 50/50, they explained that it was done for convenience, based upon the belief that the time spent administrating the HOME and Block Grant programs would even out to 50/50 by the end of the year.

Circular A-87 Requires Time Charged to an Activity to Be Supported

Each certification signed by the employees states that a timesheet is required if there are changes in work assignment or changes in time distribution of the employee. Office of Management and Budget Circular A-87 requires employees working on multiple activities to support their time with a personnel activity report or equivalent documentation, which reflects an after-the-fact distribution of

[3] This number is the average of the administrative fees expended on the HOME program from 2002 to 2004 ($772,487, $635,000, and $570,000) as discussed in Finding 1.

the actual activity of each employee. Budget estimates or other distribution percentages determined before the services are performed do not qualify as support. We were unable to locate documentation to support the actual activity completed. The Commonwealth did not make the appropriate adjustments to the employees’ time allocations as required by Office of Management and Budget Circular A-87 and its own time allocation certification requirements. Thus, the Commonwealth is unable to ensure that HOME administrative fees were used for only HOME activities.

Recommendations

We recommend that the Philadelphia Regional Office of Community Planning and Development

2A. Require the Commonwealth to establish proper time allocations that meet the requirements of Office of Management and Budget Circular A-87 and other applicable federal regulations.

SCOPE AND METHODOLOGY

To accomplish the audit objectives, we

- Reviewed applicable HUD regulations relating to the administration of the HOME program.

- Obtained a list of grantees receiving HOME program and operating grants from the Commonwealth for fiscal years 2002, 2003, and 2004 and selected a nonrepresentative sample of four sub-recipients. The selection was based on the frequency in which the sub-recipients received HOME grants from the Commonwealth and their geographic location. Each of the four grantees received at least one grant during the audit period.

- Conducted interviews with officials and employees of HUD's Community Planning and Development Division, the Commonwealth, and sub-recipients/grantees of the HOME program.

- Reviewed HOME program contracts established between the Commonwealth and the selected four grantees and obtained and reviewed contracts established among the grantees and the community housing development organizations during onsite grantee reviews.

- Reviewed general ledgers, statements of income and expenses, operating budgets, bank statements, and invoices to ensure HOME program and operating grants were used for eligible HOME activities.

We performed the majority of our fieldwork between October 2004 and May 2005 at the offices of the Commonwealth, located at the Keystone Building, 400 North Street, Harrisburg, Pennsylvania. In addition, we conducted fieldwork at the facilities of the following four grantees: Carlisle Borough, Franklin County, Monroe County, and Lebanon County. The audit generally covered the period of January 1, 2002, through September 30, 2004, but was expanded when necessary.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Management oversight processes - Policies and procedures that management has in place to reasonably ensure that improper administrative payments would not be made or would be detected in the normal course of business.

- Monitoring of HOME-eligible activities - Policies and procedures that management has in place so that adequate reviews are performed to ensure HOME grants are used for eligible activities.

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 the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Lack of management oversight.
- Lack of adequate reviews performed on the sub-recipients and/or contractors.
- Lack of adequate supporting documentation to support the use of administrative fees.

Appendixes

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation Number	Ineligible 1/	Funds to Be Put to Better Use 2/
1A	$18,957	
1B	$60,113	
1I		$6,930,916
Total	**$79,070**	**$6,930,916**

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.

2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

DEPARTMENT OF COMMUNITY
& ECONOMIC DEVELOPMENT

June 30, 2005

Mr. Daniel Temme
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development - Office of Inspector General
The Wanamaker Building
100 Penn Square East Room 1005
Philadelphia, PA 19107

Dear Mr. Temme:

Attached are our written comments to the June 21, 2005 revised discussion Draft Audit Report, as requested in the exit conference on 6/17/05 and in your transmittal of the Draft Audit Report.

Any questions or comments may be directed to me or Ed Geiger.

Sincerely,

Scott Dunwoody, Chief
Community Development Operations
Department of Community & Economic Development

Office of Community Development/Center for Community Building
Commonwealth Keystone Building400 North Street, 4th Floor, Harrisburg, PA 17120
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Comment 1

Written Comments to OIG Revised Discussion Draft Audit Report/June 30, 2005

General

We recognize that the PA Department of Community and Economic Development (DCED) has an enormous task to administer the HOME Program in Pennsylvania, however, given the amount of funds received and the number of grantees, projects, and activities, DCED believes that we have successfully managed this workload, fulfilled program requirements and utilized HOME funds efficiently and effectively.

DCED's response to OIG's Revised Discussion Draft Audit Report regarding the specific findings on ineligible expenses/activities, is set forth below. Written comments provided by DCED to the OIG at the June 17, 2005 Exit Conference, resulted in two recommendations being removed, Carlisle Borough and the Resale/Recapture issue with Franklin County. The remaining issues are: 1. Monroe County, in which DCED is working with the County and the CHDO to determine the extent of eligible costs; 2. Lebanon County, which did not violate a HOME regulation in its use of program income for administration costs; and, 3. Franklin County, where the extent to which organizational conflicts of interest have been committed remains to be determined.

After reviewing our information and clarification, we believe that HUD will discover that all of the instances cited in the OIG Draft Audit Report result from reasonable differences in interpretation of aspects of the HOME regulations between the OIG auditors and DCED, with minimal potential for any ineligible costs. More important, DCED maintains that even if HUD disagrees with our interpretation of applicable regulations in one or more of the instances cited, or some ineligible costs are found, this does not indicate that DCED did not develop and implement an adequate monitoring program of HOME grantees.

Monroe County

Monroe County's HOME grants are on DCED's monitoring schedule for 2004/05, and at that time DCED will evaluate both the Shepherds HOME project and the CHDO Operating grant. DCED missed noting and questioning the $16,000 interest expense on the CHDO Operating Budget submitted with the CHDO Application. The Executive Director's salary would be verified at closeout of the CHDO Operating grant, where HOME grantees are required to submit actual total operating costs and sources of funding for the fiscal year. This is explained in DCED's Closeout Procedures for CHDO Operating Grants, effective January 29, 2002. These procedures also state that the grantees must submit to DCED a listing of expenditures, by category, by vendor, by invoice with cost and purpose for each, for which additional supporting documentation is requested to verify the eligibility of actual expenses.

This process would identify ineligible costs, such as the interest expense and the level of the executive director's salary. In this case, we know from discussions with the grantee that the interest expense included on the budget was not actually incurred by the CHDO. The salary costs for the Executive Director that were estimated at $55,000 were reduced during 2004 due to his dismissal due to poor performance. The Administrative Assistant was promoted into the position at a reduced salary. These two items reduced the annual operating expenses for the CHDO to approximately $29,338 less than the $150,420.

This results in $14,669 of ineligible costs. DCED will be working with HUD to propose allowing additional eligible expenses incurred by the CHDO from January through June 2005 to justify the ineligible costs.

Lebanon County
DCED made significant policy changes to the HOME Program in 1998 providing greater flexibility. One of the changes was to allow grantees to keep program income to be used for eligible HOME activities. The language in the grant contract prohibiting the use of program income for administrative costs may have been included at that time to limit our administrative burden in tracking whether the grantee limited the amount to 10%, (allowable by HUD regulations for the Commonwealth's overall HOME grant). HUD regulations do not prohibit the use of program funds for administration costs, provided the 10% limitation for the overall HOME grant is not exceeded. DCED will be revisiting the issue of allowing HOME grantees to use up to 10% of their program income for administration. If allowed, the state grant contract language will be revised.

Comment 2

Lebanon County's figures document that $56,608.17 was spent on administrative costs, not $60,113, as specified in the OIG draft audit report. However, of these costs, $11,993.75 was for general administration and $44,614.42 for delivery costs for HOME eligible activities. Therefore, $11,993.75 of the $56,608.17 total costs is about 5%, well below the HOME limitation of 10%. Part of the confusion is that the Accounting Department in the County used terms such as HOME Homebuyer GA, or HOME Rehab GA, when these accounts were for staff incurring allowable delivery costs, not general administration. Corrections are being made to the account designations.

Comment 3

Franklin County/Mid-Atlantic Coalition
Regarding the alleged violation of the HOME CHDO organizational structure and operation by the Mid-Atlantic Coalition, DCED will pursue evaluating the details of this case and determine: 1) if the regulations were violated, and 2) if so, what appropriate action is required. While DCED acknowledges that violations may have occurred, the OIG draft audit report did not elaborate on the previous steps DCED took in initially certifying this CHDO. This process uncovered organizational conflicts and DCED took actions with the CHDO to rectify that situation. The OIG Draft Audit Report appears to have uncovered deception on the part of the CHDO in taking these corrective actions since that certification.

When information about potential organizational conflicts was presented to DCED during the course of the audit field work, DCED staff discussed taking the next steps to investigate this situation, but was told to hold off until OIG had completed its work. DCED therefore requests an appropriate statement of what HUD believes the conflict to be, documenting the details of what was found in the OIG Draft Audit Report, to assist us in this investigation.

Comment 4

Written Comments/ OIG Draft Audit Report
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Monitoring Program
The OIG Revised Discussion Draft Audit Report states that HOME regulations require DCED to conduct performance reviews of each subrecipient and contractor annually, and refers to these as our "grantees." The OIG Audit Report cites Section 92.504 of the HOME regulations as the basis for this requirement. However, DCED's grantees are **state recipients**, not contractors or subrecipients.

Section 92.504 states that the participating jurisdiction (PJ; which in this case is the Commonwealth), is responsible for managing the day to day operations of its HOME Program, ensuring that HOME funds are used in accordance with all program requirements. The PJ is not relieved of this overall responsibility if "state recipients, subrecipients or contractors" are involved. However, the next sentence refers to subrecipients and contractors only, not state recipients, when stating that the performance of each must be reviewed at least annually.

In summary, while the term "state recipient" is included when stating that the use of all three entities does not relieve the PJ of its responsibilities, the next sentence does <u>not</u> include state recipients, but only subrecipients and contractors, in requiring at least annual reviews.

This section of the regulations goes on to specify the requirements to be included in **agreements** between a PJ and state recipient, a PJ and subrecipient, and a PJ and contractor. There is a clear distinction in the regulations and definitions as to what each of these entities are. A state recipient is defined in Section 92.201(b)(2), as "a unit of general local government designated by a State to receive HOME funds is a State recipient." Further, Subsections 92.201(b)(2)(i) and (ii) provide: a State that uses state recipients to perform program functions shall ensure that they use the HOME funds in accordance with the requirements, and to do so, the State shall conduct such reviews and audit of its State recipients <u>as may be necessary or appropriate</u> (emphasis supplied) to determine whether the State recipient has committed and expended the HOME funds in accordance with the requirements.

A **subrecipient,** as defined in Section 92.504, is a public agency or nonprofit selected by the PJ to **administer** all or a portion of the PJ's HOME Program. This is not our State grantees. This would be applicable to the Pennsylvania Housing Finance Agency (PHFA) in its role of administering the multi-family rental program using HOME funds, for which an MOU is executed every year between DCED and PHFA, meeting the requirements of Section 92.504 for an agreement. A **contractor,** as defined in Section 92.504, is an entity that provides goods or services that are selected through applicable procurement procedures and requirements, and may **administer** all or a portion of HOME funds.

The HOME regulations, especially Section 92.550 (b) (2), state that HUD will determine whether the state has made such reviews and audits of its state recipients (our HOME grantees) as may be appropriate to determine compliance with the HOME Program requirements. This has heretofore been translated, by agreement between HUD and DCED, into a commitment by DCED to monitor its grantees on site at least once during the life of the HOME grant contract. In certain instances, depending on performance, DCED could do this more often in the case of unsatisfactory grantee performance.

While we don't believe the regulations cited by the OIG mandate an annual review by DCED of its State recipients, it is essential and in keeping with the regulations that a comprehensive process be followed to assess their performance. In addition to the on site monitoring at least once during the life of the contract, DCED receives annual performance reports from the State recipients, reviews IDIS data on drawdowns to assess progress, and maintains consistent contact with the persons administering the HOME Program dealing with interpretations and problems as they arise. We welcome HUD's involvement in working with us to develop and improve upon this ongoing assessment of our State recipients, but dispute that the program in its current form violates the applicable monitoring requirements.

DCED has incorporated the monitoring of HOME grantees into an overall monitoring approach with the CDBG and ESG Programs. Since 75% or so of HOME grantees also administer the CDBG Program, and because many housing rehab programs are jointly funded by HOME and CDBG, it makes sense to conduct the reviews concurrently. With staff vacancies during the past two years, DCED has not been able to fulfill its monitoring schedule; however, now fully staffed, we will catch up.

Comment 5

The statement in the OIG Draft Audit Report that DCED's monitoring system is largely one based on a self-assessment is inaccurate. It is incorrect to conclude, based on the fact that DCED sends out the monitoring checklist for the grantee to complete prior to the visit, or that the checklist does not contain many statements as to what was seen by the monitor, that we rely primarily on self-reporting by the grantees. There are 37 detailed statements/questions contained in the HOME Homeowner Rehabilitation/Homebuyer Checklist and 29 in the Rental Checklist, all of which are verified by the DCED monitor looking for documentation to prove compliance with the requirements. The OIG Draft Audit Report goes on to state that the monitoring reviews for Carlisle Borough, Franklin County, and Lebanon County gave no indication that the Grant Managers verified the information provided to them on the checklist. The Performance Review Report completed by the Grant Manager is the document that verifies that the monitor conducted the monitoring and what conclusions were reached. Where violations or ineligible cost determinations are found, they are described along with recommendations for improvement or actions to be taken to achieve compliance or restitution.

Also, the statement by a DCED official in the OIG Draft Audit Report that "the staff are not experts in the HOME Program" is quoted out of context. It was stated by the Division Chief primarily in response to the detailed discussion concerning the Mid-Atlantic organizational conflicts issue, a specific topic which requires a level of specialized expertise not normally found in, or needed by, even veteran staff.

Staffing Levels
The past few years have seen three retirements of Grant Managers, which DCED recognizes has disrupted our ability to meet our responsibilities fully in administering three federal programs, totaling nearly $100M annually. When fully staffed with five experienced Grant Managers, it has been our history during the past ten years to be able to successfully administer these programs.

Unspent Administrative Funds
DCED acknowledges the need to reduce the significant balance of unspent administrative costs. DCED has recently approved approximately $3.4M of HOME projects converting the administrative funds to make these project grants, leaving a balance of just over $3M. Discussion is underway considering options for the use of most of the remaining balance.

Comment 6

DCED does not consider its administration and monitoring of the HOME Program to be inadequate or to lack effective management oversight, and the OIG Draft Audit Report does not justify taking measures such as hiring additional staff or revamping systems that are in place. It is acknowledged that retirements and the time required in filling those vacancies during the past two years have significantly reduced our ability to keep up with the monitoring schedules, however, being fully staffed again with highly qualified individuals should enable re-establishment of continuity and effectiveness.

It has been recognized during the past few years that additional training is needed for the Grant Managers, especially the new staff, in specific areas of expertise. This training will be accomplished in the next year from a variety of sources.

Inadequate Time Allocation
In the 1990s, there was some analysis developed to serve as a basis for the division of staff time between CDBG and HOME on a 50%/50% split. Not being able to locate those files, rather than expending effort to try to reestablish the basis, DCED agrees that it is appropriate to establish a basis or a distribution of administrative costs for CDBG, HOME and ESG. DCED will work with HUD to meet the requirements of A-87.

OIG Evaluation of Auditee Comments

Comment 1 Although we acknowledge the Commonwealth has procedures to conduct closeout reviews, the Commonwealth did not perform a closeout review of Monroe County's Operating Grant. Further, based on the evidence we gathered during the audit we question whether the Commonwealth actually completes closeout reviews. For example, the division chief stated the Commonwealth auditors recently asked the Commonwealth to provide support of audit closeouts, but the Commonwealth was not able to find or provide them with audit closeouts for the community housing development organization operating grants.

Comment 2 Based upon our review, we identified $60,113 in ineligible expenditures. If Lebanon County provided additional documentation to justify eliminating some of these expenditures, HUD program staff can verify this in the audit resolution process.

Comment 3 Initially the Commonwealth took some actions to certify that Mid-Atlantic was organized properly. However, as the audit showed there were several events in their dealings with Mid-Atlantic which should have led them to question Mid-Atlantic's organizational structure. For example, Mid-Atlantic's original executive director was asked by the Commonwealth to certify independence between his for-profit company and Mid-Atlantic. In response to that request, the executive director resigned from Mid-Atlantic, but continued to represent Mid-Atlantic in the majority of Mid-Atlantic's dealings with the Commonwealth.

Comment 4 We agree the regulations pertaining to the annual review requirements are limited to contractors and sub-recipients and adjusted the report accordingly. Although the HOME regulations do not require annual monitoring of State Recipients, *Code of Federal Regulations*, title 24, parts 92.201 (b)(2)(i) and (ii) provide the Commonwealth must conduct such reviews and audit of its State Recipients as may be necessary to determine whether the State Recipient has met the requirements of the HOME and other federal regulations. Based on the results of our reviews we believe the Commonwealth's monitoring is infrequent and the Commonwealth's overall monitoring program is not adequate to ensure the State Recipients are using HOME funds in accordance with HOME and other federal regulations.

Comment 5 In addition to reviewing the monitoring checklists, we also reviewed the performance review reports provided for Carlisle Borough, Franklin County, and Lebanon County. These reports gave no indication the grant managers verified the information provided by the localities to the Commonwealth. In addition, the performance reports are vague and do not show what documents and/or support were reviewed to verify the information provided on the checklists. In fact, the Commonwealth had no findings for all three grantees we reviewed.

Comment 6 We disagree with the Commonwealth's assessment that the HOME program is adequately monitored and has efficient management oversight. As our audit report demonstrates, the Commonwealth conducts infrequent and limited monitoring visits of its grantees, has minimal staff, and is not fully using the administrative funds available to manage the program. These monitoring deficiencies directly contributed to the problems we identified in how several grantees used their HOME funds