



Issue Date May 31, 2006
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Audit Report Number 2006-SE-1003
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TO: Jack Peters, Director, Region X Office of Community Planning and Development, OAD

*Joan S. Hobbs*

FROM: Joan Hobbs, Regional Inspector General for Audit, Region X, OAGA

SUBJECT: Snohomish County's Office of Housing and Community Development, Everett, Washington, Charged Ineligible Administrative Expenses to its Community Development Block Grant

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the Snohomish County (County) Office of Housing and Community Development in response to a request from the U.S. Department of Housing and Urban Development's (HUD) Seattle Office of Community Planning and Development.

Our audit objective was to determine whether the County administered its Community Development Block Grant and HOME Investment Partnership Program in accordance with HUD requirements. More specifically, our objectives were to determine whether (1) only eligible administrative expenses were charged to the County's Community Development Block Grant and HOME Investment Partnership Program funds and (2) the County followed HUD's guidelines relating to its float-funded Community Development Block Grant programs.

## **What We Found**

Snohomish County generally administers its Community Development Block Grant and HOME Investment Partnership Program grants in accordance with HUD requirements. However, the County charged \$67,339 of ineligible administrative expenses to its Community Development Block Grant. The County also extended the pay-off date for two Community Development Block Grant float-funded activities without properly identifying the loan extensions as a new activity, as required.

## **What We Recommend**

We recommend that HUD require the County to (1) reimburse its Community Development Block Grant and/or repay HUD from nonfederal funds for the \$67,339 in expenses related to ineligible administrative activities; (2) establish and implement adequate procedures for charging administrative costs that meet federal requirements; and (3) establish and implement adequate procedures for its float loan program.

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**

We provided the County a draft report on May 4, 2006. The County provided written comments on May 19, 2006. It agreed to establish and implement adequate procedures that comply with HUD regulations. However, it disagreed that the administrative expenses should be repaid.

The complete text of the auditee'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**

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Snohomish County (County) is in Washington State, north of Seattle on Puget Sound. The County offices are located on 3000 Rockefeller Ave, Everett, Washington. The County's Office of Housing and Community Development is responsible for administering, monitoring, and supporting various U.S. Department of Housing and Urban Development (HUD) programs for the County, including:

- Community Development Block Grant
- Emergency Shelter Grant
- HOME Investment Partnership Program
- American Dream Downpayment Initiative
- Supportive Housing Program

Together, these grants provide approximately \$7 million annually in HUD funds to benefit the homeless and low-to moderate-income people in the County. The County awards the HUD funds to nonprofit and local Government subrecipients to carry out eligible activities and receives 20 percent of the total Community Development Block Grant and 10 percent of HOME Investment Partnership Program funds for administering these activities.

Besides its HUD programs, the Office of Housing and Community Development also administers the County's State-funded Affordable Housing Trust Fund, which is used for the development of affordable housing, and the County's \$1.3 million Hotel/Motel Tax program.

The Community Development Block Grant Entitlement program was established by Title I of the Housing and Community Development Act of 1974 (1974 Act), Public Law 93-383. The act grants states and units of general local government aid in the development of viable urban communities. This is done by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. The Entitlement Grants are allocated to designated jurisdictions including metropolitan cities or urban counties.

The County annually receives approximately \$3.3 million in Community Development Block Grant funds. These funds support a variety of activities directed at improving the physical condition of neighborhoods through the provision of housing; public improvements and facilities; creating employment; or improving services for low and/or moderate-income households. Generally, the County has a fund balance with the U.S. Department of the Treasury, awaiting draw requests from the County to pay invoices submitted by organizations carrying out Community Development Block Grant activities.

If the County has a fund balance available, it can provide interim financing (not to exceed 30 months) to public, private nonprofit and private for-profit organizations for projects in the County that meet Federal guidelines. The purpose for this program is to support projects that will assist the County in accomplishing specific Community Development Block Grant-eligible housing, community and economic development goals through the availability of short-term, lower-rate financing. An activity that uses such funds is referred to as a float-funded or float loan activity. Each activity using a float loan must meet all of the same requirements applying to Community Development Block Grant-assisted activities and must be repaid in a timely manner. When the County proposes to fund such an activity, it must include the activity in its action plan or amend the action plan for the current program year.

Our audit objective was to determine whether the County administered the Community Development Block Grant and HOME Investment Partnership Program in accordance with HUD requirements. We wanted to determine whether (1) only eligible administrative expenses were charged to the County's Community Development Block Grant and HOME Investment Partnership Program funds, and (2) the County followed HUD's guidelines relating to its float-funded Community Development Block Grant programs.

## RESULTS OF AUDIT

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### Finding 1: The County Charged Ineligible Administrative Expenses to Its Community Development Block Grant

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The County used Community Development Block Grant funds to pay a portion of the administrative expenses for its Emergency Shelter Grant, Supportive Housing Program, and Washington State Affordable Housing Trust Fund. This occurred because the County did not fully understand HUD and Office of Management and Budget requirements that prohibit using Community Development Block Grant administrative funds for the administration of these programs. As a result, \$67,339 was not available for eligible Community Development Block Grant activities.

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**Federal Regulations Specify  
What Activities Can Be  
Charged to a Community  
Development Block Grant for  
Administration**

HUD regulations allow the County to charge up to 20 percent of its total Community Development Block Grant funds for payment of reasonable administrative costs and carrying charges related to the planning and execution of community development activities. Eligible activities include:

- General management, oversight and coordination of Community Development Block Grant activities;
- Public information activities;
- Fair housing activities;
- Indirect costs associated with these activities;
- Submission of applications for federal programs;
- Administrative expenses to facilitate housing; and
- Reasonable costs for overall management of the HOME program.

Office of Management and Budget Circular A-87, “Cost Principles for State and Local Governments,” states that amounts not recoverable as administrative costs on one federal award may not be shifted to another federal award unless specifically authorized by federal regulation. HUD allows planning, grant application, and other general administrative costs of other federal awards to be paid for with Community Development Block Grant administration funds.

However, costs directly associated with the management, oversight and coordination of Emergency Shelter Grant and Supportive Housing Program funds cannot be paid for with Community Development Block Grant administration funds. In addition, these funds cannot be used to pay administrative costs of any nonfederal activities.

**The County Charged \$67,339 in Ineligible Administrative Costs to its Community Development Block Grant**

Generally, the County's procedures for charging expenditures to Community Development Block Grant administration were compliant with federal regulations and the County's timekeeping procedures properly collect labor costs by grant activity. However, County officials did not fully understand what activities were eligible.

Consequently, from January 1, 2004 through December 31, 2005, the County shifted \$47,304 and \$13,327 in labor costs respectively for management of its Supportive Housing Program and Emergency Shelter Grant to its Community Development Block Grant. These ineligible charges were made to the Community Development Block Grant at times when the other programs did not have funds available to meet all their programs' costs. Further, contrary to Office of Management and Budget requirements, the County charged its Community Development Block Grant \$6,547 in labor costs for planning activities relating to its Affordable Housing Trust fund, a nonfederal program. As a result, \$67,339 of Community Development Block Grant funds was unavailable for eligible activities.

**Recommendations**

We recommend that the director of the Region X Office of Community Planning and Development require the County to

1A. Reimburse the grant and/or repay HUD, from nonfederal funds, \$67,339 for ineligible administrative costs charged to its Community Development Block Grant.

1B. Require the County to establish and implement adequate procedures for charging administrative costs that meet Federal requirements so that \$67,339 in Community Development Block Grant funds will be available for eligible activities.

## Finding 2: Snohomish County Extended Float Loan Pay-off Dates Without Identifying a New Activity

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The County extended the pay-off date for two Community Development Block Grant float-funded activities without properly identifying the loan extensions as a new activity, as required. This occurred because the County did not fully understand the extension requirements. As a result, HUD was not fully aware of how the County was utilizing its Community Development Block Grant funds.

### **HUD Allows Community Development Block Grant Funds to Be Used for Interim Financing**

HUD allows grant recipients to use Community Development Block Grant funds to provide interim financing (not to exceed 30 months) to public, private nonprofit and private for-profit organizations, if the grant recipient has a fund balance available. The purpose of the interim financing, or float loan, program is to provide lower rate financing support to projects that will assist the grantee in accomplishing specific Community Development Block Grant housing, community, and economic development goals.

Each activity carried out using a float loan must meet all of the same requirements that apply to other grant-assisted activities, and must be repaid in a timely manner. When a grantee, such as Snohomish County, proposes to fund such an activity, it must include the activity in its action plan or amend the action plan for the current program year. HUD regulations state that any extension of the float loan repayment period shall be considered a new float-funded activity with the same limitations and requirements as a new activity. New activities require identification of how the loan funds will be used to meet a Community Development Block Grant national objective. The objective cannot be the same as the original float-funded activity.

### **The County Did Not Comply With Extension Regulations**

The County extended the term of two Community Development Block Grant float loans beyond their originally scheduled payoff dates without identifying new purposes for the funds, as required. The loans provided Housing Hope, a nonprofit subrecipient, with interim funds to acquire property for housing. The County



extended the due date for repayment of a \$210,000 float loan to purchase the Avondale Project from March 13 to September 13, 2005. The County also extended the final \$608,000 repayment of a \$808,000 float loan for the Stanwood Expansion purchase from February 20 to June 19, 2005. Housing Hope needed the float loan extensions due to problems securing permanent financing. In both cases, County management determined that the delays encountered were legitimate. The decisions to extend the loans were made only after assuring that no other projects would be jeopardized by granting the extensions.

### **The County Did Not Fully Understand the Extension Requirements**

The County did not fully understand the requirement to identify the float loan extensions as a new purpose for their Community Development Block Grant funds. The County believed all that was needed was to ensure that (1) a request was generated by legitimate and unanticipated complicating developments, (2) no pending projects would be compromised by extending the terms of a loan, and (3) the letter of credit guaranteeing the loan was extended beyond the revised term of the loan. All three of these conditions were met for both loan extensions.

### **Recommendations**

We recommend that the director of the Region X Office of Community Planning and Development require the County to

2A. Establish and implement adequate procedures for its float loan program.

## SCOPE AND METHODOLOGY

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We performed the audit between December 2005 and April 2006. The audit generally covered the period from January 2004 through June 2005. We expanded the scope as necessary. We reviewed applicable guidance and discussed operations with management and staff personnel from the County and key officials from HUD's Seattle Office of Community Planning and Development. Our primary methodologies included

- Reviewing the Proposal Plan and Consolidated Annual Performance and Evaluation Report, to determine whether the activities are eligible, the types of activities being funded, amount of funding, and progress in completing the activities.
- Reviewing the latest audited financial report.
- Analyzing the grantee's financial information from its accounting records.
- Reviewing the minutes of meetings and resolutions enacted by the grantee's governing board.
- Reviewing the grantee's organizational, functional, and staffing charts.
- Reviewing the County's monitoring of subrecipients.
- Analyzing Community Development Block Grant float loan documentation for compliance with HUD requirements.
- Analyzing select County administrative costs for compliance with Office of Management and Budget cost principles.
- Reviewing select claims from subrecipients to determine whether they are adequately documented and contain any costs that are not compliant with the cost principles.

We conducted our audit in accordance with generally accepted government auditing standards and included tests of management controls that we considered necessary under the circumstances.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Policies and procedures to ensure grant expenditures were eligible and adequately supported.
- Policies and procedures to ensure adequate financial management and record-keeping systems.

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:

The County did not have

- Policies and procedures in place to ensure that only eligible administrative expenditures were charged to the Community Development Block Grant (finding 1) and
- Policies and procedures in place to ensure that float loans were administered according to HUD requirements (finding 2).

## 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	\$67,339	
1B		\$67,339


- 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 (OIG) 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. The amount shown represents funds that, if recommendation 1B is implemented, will be available to the County’s Community Development Block Grant program for eligible activities over the next two years.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments



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Planning and Development Services

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May 11, 2006

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Dear Ms. Hobbs,

Thank you for the opportunity to provide a written response to your draft audit report 2006 for Snohomish County's Office of Housing & Community Development (OHCD), dated May 4. We have comments in two specific areas: 1) the recommendation that the County be required to repay funds; 2) the representation of the County's management of the Float Loan program

Recommendation for Repayment of Funds: Your draft report recommends that the County be required to "reimburse its Community Development Block Grant and/or repay HUD from nonfederal funds for the \$67,339 in expenses related to ineligible activities." During the field work portion of the audit, County staff and Field Audit Lead, [REDACTED] met in person and exchanged emails regarding the issue of determining eligibility of expenses charged to CDBG Administrative funds. County staff cited several CFR points in Section 570.206, including 570.206 (i)(2) regarding eligibility of HOME activities under CDBG Administrative funds, of which the Seattle CPD Field Office staff and the Field Auditor did not appear to be aware prior to our bringing it to their attention.

County staff also cited CFR 570.206(g), which states that "for entitlement recipients, assistance authorized by this paragraph is limited to units which are identified in the recipient's HUD approved housing assistance plan." Snohomish County's HUD approved plan is our Consolidated Plan which covers all of our activities focused on housing for low and moderate income persons. It has been our interpretation that this citation means that CDBG funds can be used to cover work related to any of the housing units identified in our Consolidated Plan, therefore making the expenses in question eligible for CDBG. County Staff verified through informal conversations that managers of CPD funds in other jurisdictions similarly interpret this CFR reference to allow costs incurred in other housing programs with units delineated in their Consolidated Plans. Additionally, there is no further written clarification of this matter in existing regulations or CPD Notices.

**Comment 1**

**Comment 2**

**Names have been redacted for privacy**

**Comment 3**

During the course of exchanges related to this topic, several different approaches to the issue were represented to us as the proper interpretation of what activities would have been allowed under CDBG Administrative funds. It did not appear that either CPD Field Office Staff or the Lead Field Auditor had any prior definition or interpretation on this subject. It was further expressed to us verbally that this audit was being used by the CPD Field Staff as an opportunity to further define and restrict the uses of CDBG Administrative dollars beyond guidance that has previously been available. Finally, we were clearly reassured prior to working through calculations of what might be ineligible expense that we would not be required to pay these funds back, given the fact that tighter restrictions had never previously been discussed or defined, but rather that we would be required to establish a plan to ensure in the future that funds were used according to this newly articulated interpretation of the CFR.

It is our strong opinion that if HUD, either at the national or regional level, desires to use this audit report as opportunity to further define or articulate restrictions on fund use beyond what has been available, then we should not be penalized for not operating under guidelines never previously shared with us. If it is the case that the report's interpretation of the CFR citations correctly reflects HUD's intentions all along, then the CPD Field Office has failed in its mission of providing helpful and reasonable guidance to us and other jurisdictions under its province.

**Comment 4  
Comment 5**

The County is more than happy to establish new procedures and internal guidelines to respond to any and all clear definitions and regulations provided to us for proper use of all funds we receive from any source. We view our stewardship obligations as of the utmost importance and manifest a clear code of ethics and integrity in our operations of these funds. This is also evidenced by the Lead Auditor's comments in a meeting with County Staff that we have "one of the best cost allocation systems she had ever seen." This is a substantially positive observation of our operations, yet it is not reflected in the final draft audit report. Additionally, the Lead Auditor remarked several times on her faith in the new management of the unit and organizational plans for the future. This also was not reflected in the draft report.

We have been quite happy to work with the Field Auditors and have maintained an open and accessible communication mode throughout the audit which has been remarked upon regularly in person and emails by the Lead Auditor, who has also been aware of the fact that we have already moved to incorporate various program "tweaks" based on her observations and advice. Clearly, we are a jurisdiction dedicated to the proper and ethical use of funds in service of our citizens. This is not reflected in the draft report.

**Comment 3**

Based on all of the above points, we strongly object to the recommendation to require the County to repay funds, which we see as a clear retroactive requirement not appropriate to prior guidance from HUD. Again, as indicated above, we are happy to revise our procedures based on clarified regulations.

**Comment 6**

Float Loan Program: The draft audit report includes a second finding regarding the extension of two float loans and recommends that the County establish and implement adequate procedures for the float loan program. We object to the characterization provided in the detailed language of Finding 2 which implies that the County tied up HUD funds longer than is allowed. In fact, at no time did our float loan periods extend beyond the federally allowed 30 month period. The point

**Comment 7**

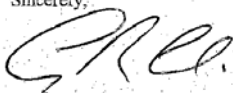
of concern and compliance issue came about as a result of the County's ambitious goals to get float loan funds repaid more quickly than required. In two instances, the County contracted the use of float loans with repayment periods significantly shorter than 30 months. When the recipient organization experienced temporary permanent financing shortfalls, the loans repayments were delayed a few months, but never for a total loan period of greater than 30 months. The misunderstanding in the County was the requirement that extensions must be treated as new activity with new contracts and all attendant details. We have already adjusted our float loan procedures to ensure that initial loan contract periods are more conservative for the recipient, while remaining in the 30 month period.

Based on the above, we request that the final report remove the reference on page 8 stating "as a result, Community Development Block Grant funds weren't returned to HUD in a timely manner," and instead reflect the reality that the finding arose out of the County's desire to return funds as quickly as possible, and in two instances more quickly than wound up being possible, but in no instance did the County allow funds to remain unpaid for longer than the regulatory 30 month period.

In closing, we would like to once again thank you for the opportunity to provide a written response to your draft report. We would also like to commend the manner and interpersonal skills of the Lead Auditor, [REDACTED] whose approach to the task was encouraging and engaging, leading to interesting and valued discussions with the OHCD Unit Supervisor regarding effective management techniques for these programs.

Thank you for your consideration of our remarks and any efforts made to incorporate them into your final report. Please don't hesitate to contact me as necessary.

Sincerely,



Craig R. Ladiser  
Director

## OIG Evaluation of Auditee Comments

- Comment 1** The County only cited part of the regulation. The regulation states "CDBG funds may be used for necessary administrative expenses in **planning or obtaining financing for housing** as follows: for entitlement recipients, assistance authorized by this paragraph is limited to units which are identified in the recipient's HUD approved housing assistance plan; ..." (emphasis added). As noted in the finding, costs for management of its Supportive Housing Program and Emergency Shelter Grant are not eligible Community Development Block Grant expenses.
- Comment 2** The funding approval/agreement signed by the County states "The funding assistance specified in the Funding Approval may be used to pay costs ... provided the activities to which such costs are related are carried out in compliance with all applicable requirements." Therefore, the County is responsible for ensuring that the costs are compliant with the requirements, including 24 CFR 570 and OMB Circular A-87.
- Comment 3** The repayment of funds is not based on a retroactive requirement. It is enforcement of an existing regulation. The costs are ineligible, therefore must be repaid.
- Comment 4** The issue wasn't with the cost allocation system, but the labor hours that were input into the system. The staff charged their time to the activities worked on, however they were shifted to the Community Development Block Grant when funds weren't available on the grant charged.
- Comment 5** We agree. The new management has already made significant changes that reflect positively on the organization. We limited our audit scope due to the changes that we observed.
- Comment 6** We modified the finding and removed the reference regarding the timeliness of the repayment of Community Development Block Grant funds to HUD. The finding is that the County violated the regulations when it extended the float loans without identifying a new activity as required by 24 CFR 570.301, not whether or not HUD was repaid timely. We are not recommending that the County repay any of the loan funds, only that they revise their procedures to comply with the regulations.
- Comment 7** The procedures also need to be revised to ensure that if a float loan is extended, a new activity is identified.



## Appendix C

### CRITERIA

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- A. Title I of the Housing and Community Development Act of 1974 Act, Public Law 93-383, as amended, authorizes the Community Development Block Grant program. Entitlement grants authorized by the Act are allocated to designated metropolitan cities or urban counties (almost 900 nationwide). The entitlement amount is determined by applying either one of two formulas. One formula considers the grantee's population, extent of poverty, and housing overcrowding. The other formula considers the grantee's extent of growth lag, extent of poverty, and age of housing.
- B. Office of Management and Budget Circular A-87, Cost Principles for State, Local and Indian Tribe Governments, 2004, Attachment A, section F, paragraph 3, subparagraph b, "Limitation on Administrative Costs," states, "Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation."
- C. 24 CFR [*Code of Federal Regulations*] 570.206(f) states, "...CDBG funds may be used to prepare applications for other Federal programs where the recipient determines that such activities are necessary or appropriate to achieve its community development activities."
- D. 24 CFR 570.206(g) states, "Administrative expenses to facilitate housing. CDBG funds may be used for necessary administrative expenses in planning or obtaining financing for housing as follows: for entitlement recipients, assistance authorized by this paragraph is limited to units which are identified in the recipient's HUD approved housing assistance plan;"
- E. 24 CFR 570.301(b)(2)(ii) states, "Any extension of the repayment period for a float-funded activity shall be considered to be a new float-funded activity for these purposes and may be implemented by the grantee only if the extension is made subject to the same limitations and requirements as apply to a new float-funded activity."