
AUDIT REPORT



CITY OF ST. RHINELANDER
ECONOMIC DEVELOPMENT INITIATIVE – SPECIAL
PURPOSE GRANT (B-02-SP-WI-0779)

RHINELANDER, WISCONSIN

HUD's Interest in \$47,668 in Grant Funds Awarded to the City
Was Not Secured

2006-CH-1003

DECEMBER 5, 2005

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



Issue Date	December 5, 2005
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Audit Report Number	2006-CH-1003
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TO: Francis P. McNally, Director of Congressional Grants, DECC

FROM: 
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: HUD's Interest in \$47,668 in Economic Development Initiative – Special Purpose Grant Funds Awarded to the City of Rhinelander, Wisconsin Was Not Secured

HIGHLIGHTS

What We Audited and Why

We audited the City of Rhinelander, Wisconsin's (City) Economic Development Initiative – Special Purpose Grant (Grant). We initiated the audit in conjunction with our internal review of the U.S. Department of Housing and Urban Development's (HUD) oversight of Economic Development Initiative – Special Purpose Grants. The review is part of our fiscal year 2005 annual audit plan. We chose the City's Grant based upon a statistical sample of fiscal years 2002 and 2003 Economic Development Initiative – Special Purpose Grants, in which 90 percent or more in funds were disbursed. Our objectives were to determine whether the City used its Grant funds in accordance with HUD's requirements and recorded HUD's interest on the assisted property.

What We Found

The City used the Grant funds in accordance with HUD's requirements. It used \$120,000 in Grant funds to pay for the reconstruction of U.S. Highway 8, which included the construction of a rail spur crossing (\$72,332) and access road (\$47,668). However, it did not place a covenant on the property title for the access road assuring nondiscrimination based on race, color, national origin, or

handicap. Further, HUD did not request the City to record HUD's interest on the access road's property title.

Although the rail spur crossing is also real property based on HUD's requirements, we believe it is not practical to place a covenant on the rail spur crossing's property title since the crossing is not a building or land where discrimination could occur. Further, we believe that it is highly unlikely that the land where the rail spur crossing is located would be sold or change its purpose since the crossing is located on U.S. Highway 8. Therefore, we did not recommend the placing of a covenant or the securing of HUD's interest on the rail spur crossing's property title.

What We Recommend

We recommend that HUD's director of congressional grants require the City to record a covenant on the title assuring nondiscrimination based on race, color, national origin, or handicap and record a lien on the property titles for the access road showing HUD's interest in the assisted property. If the covenant and lien are not recorded, the City should reimburse HUD \$47,668 from nonfederal funds for the Grant funds used to pay for the construction of the access road.

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 Response Not Provided

We provided our discussion draft audit report to the City's attorney/administrator and HUD's staff during the audit. We attempted to schedule an exit conference with the City's attorney/administrator but were not successful since the attorney/administrator did not respond to our offers as of December 4, 2005.

We asked the City's attorney/administrator to provide comments on our discussion draft audit report by December 2, 2005. As of December 4, 2005, the City had not provided any comments on the discussion draft audit report.

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BACKGROUND AND OBJECTIVES

The Economic Development Initiative program. The U.S. Department of Housing and Urban Development's (HUD) Economic Development Initiative program includes noncompetitive Economic Development Initiative – Special Purpose Grants. HUD awards Economic Development Initiative – Special Purpose Grants to entities included in the U.S. House of Representatives' conference reports.

The City of Rhinelander, Wisconsin. Organized under the laws of the State of Wisconsin, the City of Rhinelander (City) is governed by a mayor and an eight-member council. The U.S. House of Representatives' Conference Report 107-272 set aside \$120,000 in Economic Development Initiative – Special Purpose Grant (Grant) funds to the City for the construction of a rail spur. In June 2004, HUD awarded the City a \$120,000 Grant to pay for the reconstruction of United States Highway 8, which included the construction of a rail spur crossing and an access road. The City's attorney/administrator administered the Grant. The City's records for the Grant are maintained at Rhinelander City Hall, located at 135 South Stevens Street, Rhinelander, Wisconsin.

We initiated the audit in conjunction with our internal review of HUD's oversight of Economic Development Initiative – Special Purpose Grants. The review is part of our fiscal year 2005 annual audit plan. We chose the City's Grant based upon a statistical sample of fiscal years 2002 and 2003 Economic Development Initiative – Special Purpose Grants, in which 90 percent or more in funds were disbursed.

Our objectives were to determine whether the City used its Grant funds in accordance with HUD's requirements and recorded HUD's interest on the assisted property.

RESULTS OF AUDIT

Finding: HUD's Interest in \$47,668 in Grant Funds Awarded to the City Was Not Secured

The City used \$120,000 in Grant funds to pay for the reconstruction of U.S. Highway 8, which included the construction of a rail spur crossing (\$72,332) and access road (\$47,668); however, the City did not place a covenant on the property title for the access road assuring nondiscrimination based on race, color, national origin, or handicap. Further, HUD did not request the City to record HUD's interest on the property title for the access road. The City did not record the covenant on the title because it lacked effective oversight of applicable Grant requirements. As a result, HUD's interest in the access road is not protected.

The City Used \$47,668 in Grant Funds without Placing a Covenant on the Title to Ensure Nondiscrimination

Contrary to federal requirements, the City did not secure HUD's interest in \$47,668 in Grant funds used to pay for the construction of an access road for Ponnse USA, Inc. (Ponnse). The funds were disbursed in September 2004. The City obtained the land for the access road from Laser Pros International Corporation (Corporation). The City, in its agreement with the County of Oneida and the Corporation for the land, agreed to allow the Corporation to have right of first refusal to acquire Ponnse's land upon cessation of Ponnse's business.

The City failed to place a covenant on the access road's property title to assure nondiscrimination based on race, color, national origin, or handicap. The purpose of the covenant is to ensure nondiscrimination for the period that the access road is used as outlined in the City's application for the Grant or for another purpose involving similar services or benefits. The recording of the covenant will provide HUD recourse if discrimination based on race, color, national origin, or handicap occurs in relation to the access road.

HUD's Interest in the Access Road Is at Risk

The City's attorney/administrator said HUD did not provide the City any directives or guidance regarding the securing of HUD's interest in the access road. Additionally, the attorney/administrator said the City lacked experience regarding HUD grants. However, the City assured it would place a covenant on

the real property's title to assure nondiscrimination during the useful life of the project. The recording of the covenant will provide HUD recourse if discrimination based on race, color, national origin, or handicap occurs in relation to the access road.

HUD Did Not Request the City to Record HUD's Interest on the Access Road

HUD did not request the City to record HUD's interest on the property title for the access road. The recording of HUD's interest in the road will help protect HUD in case the road is sold or is no longer used for its intended purpose. The City's mayor certified in Standard Form 424D, Assurances – Construction Programs, section 3, that the City would record the federal interest in the title of real property in accordance with awarding agency directives.

HUD's Office of Congressional Grants' position is that the Standard Form only requires the City to record HUD's interest in the access road, if HUD issued a directive that requires applicants to record HUD's interest in real property or HUD specifically directs the City to record HUD's interest in the road. HUD did not issue any directives requiring grant recipients to record HUD's interest in real property or specifically direct the City to record HUD's interest. However, HUD clearly has the authority to require a grantee to record HUD's interest in an assisted property. Therefore, HUD's interest in the access road is not protected in case it is sold or is no longer used for its intended purpose.

Recommendations

We recommend that HUD's director of congressional grants require the City to

- 1A. Record a covenant on the title assuring nondiscrimination based on race, color, national origin, or handicap and record a lien on the property title for the access road. The covenant and lien should help ensure that the City protects HUD's interest in the \$47,668 in Grant funds for the road.
- 1B. Reimburse HUD from nonfederal funds for the Grant funds used to pay for the construction of the access road if the covenant and lien are not recorded.

SCOPE AND METHODOLOGY

We performed the audit at the City's city hall in September 2005. To accomplish our objectives, we interviewed HUD's staff and employees of the City, the Wisconsin Department of Transportation, and Laser Pros International Corporation.

To determine whether the City used Grant funds in accordance with HUD's requirements and recorded HUD's interest on the assisted property, we reviewed

- U.S. House of Representatives' Conference Report 107-272,
- HUD's file related to the Grant,
- The City's financial records, and
- The City's website for organizational information on the City.

We also reviewed 24 CFR [*Code of Federal Regulations*] Parts 1, 8, and 85; 56 *Federal Register* 16337; 70 *Federal Register* 18193; HUD Directives 1.5, 8.50, and 85.31; Office of Management and Budget Circulars A-21, A-87, A-110, and A-122; and HUD Handbook 2000.06, REV-3.

The audit covered the period from June 16, 2004, through August 31, 2005. This period was adjusted as necessary. We performed our audit 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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weakness

Based on our audit, we believe the following item is a significant weakness:

- The City did not record the covenant on the title because it lacked effective oversight of applicable Grant requirements.

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to Be Put to Better Use 1/
1A	<u>\$47,668</u>
Total	<u>\$47,668</u>

1/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an 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.

Appendix B

FEDERAL REQUIREMENTS

The City's Grant Agreement with HUD, article I, section B, states the grant funds must be made available in accordance with 24 CFR [*Code of Federal Regulations*] parts 1 and 8. Section E of article I states the City will comply with 24 CFR [*Code of Federal Regulations*] part 85.

According to 24 CFR [*Code of Federal Regulations*] 1.5(a)(2), in the case of real property, structures or improvements thereon, or interests therein, acquired through a program of federal financial assistance, the instrument effecting any disposition by the recipient of such real property, structures or improvements thereon, or interests therein, shall contain a covenant running with the land assuring nondiscrimination based on race, color, or national origin for the period during which the real property is used for a purpose for which the federal financial assistance is extended or for another purpose involving the provision of similar services or benefits.

According to 24 CFR [*Code of Federal Regulations*] 8.50(c)(2), when no transfer of property is involved, but property is purchased or improved with federal financial assistance, the recipient shall agree to include a covenant in the instrument effecting or recording any later transfer of the property for the period during which it retains ownership or possession of the property to assure nondiscrimination based on a handicap.

HUD Directive 85.31 and 24 CFR [*Code of Federal Regulations*] 85.31(a) state title to the real property shall vest in the recipient as long as the recipient uses the real property for its authorized purpose and does not encumber the real property without HUD's approval. Section 85.31(c) states when the real property is no longer needed for the authorized purpose, the recipient shall request disposition instructions from HUD. HUD shall require the recipient to do the following: (1) retain title to the real property without further obligation to the federal government after it compensates the federal government the percentage of the current fair market value of the real property attributable to the federal participation in the project; (2) sell the real property and compensate the federal government for the percentage of the current fair market value of the real property attributable to the federal participation in the project; or (3) transfer title to the real property to the federal government or to an eligible third party and be entitled to compensation for its percentage of the current fair market value of the real property.

According to 56 *Federal Register* 16337, "directive" means a handbook (including a change or supplement), notice, interim notice, special directive, and any other issuance that the department may classify as a directive.

The City's mayor certified in Standard Form 424D, Assurances – Construction Programs, section 3, that the City would record the federal interest in the title of real property in accordance with awarding agency directives and would include a covenant in the title of real property acquired in whole or in part with federal assistance to assure nondiscrimination during the useful life of the project.