



Issue Date	September 24, 1997
Audit Case Number	97-CH-241-1011

TO: Richard T. Hendershot, Acting Director, Community Planning and Development,
Ohio State Office

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: City of Cleveland
Hough Area Partners In Progress, Inc.
Community Development Block Grant Program
Empowerment Zone Program
Cleveland, Ohio

We completed an audit of the Community Development Block Grant and Empowerment Zone funds provided by the City of Cleveland to its subrecipient Hough Area Partners In Progress, Inc., a non-profit Corporation located in Cleveland, Ohio. The objectives of our audit were to determine whether Hough accounted for and used the funds in accordance with Federal regulations. We performed the audit at the request of the General Deputy Assistant Secretary.

We concluded that Hough did not fully comply with Federal Regulations regarding the Community Development Block Grant Program and Empowerment Zone Program. Hough did not pass \$29,381 it received from the City of Cleveland to third parties for which payments were intended. In addition, Hough did not provide us adequate documentation to support payments totalling \$13,274. These problems occurred prior to the establishment of Hough's current internal control system. After March 1, 1996, Hough improved its system of internal controls when it hired a local certified public accounting firm as its fiscal officer. Hough also hired a checking service to make all of Hough's payments and provide cash analysis and reports.

Within 60 days, please give us, for each recommendation made in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

If your staff have questions, please have them contact me or my assistant, Kathleen Creighton, at (312) 353-7832.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Executive Summary

We completed an audit of Community Development Block Grant and Empowerment Zone funds provided by the City of Cleveland to its subrecipient Hough Area Partners In Progress, Inc., a non-profit Corporation located in Cleveland, Ohio. The objectives of our audit were to determine whether Hough accounted for and used the funds in accordance with Federal regulations. We performed the audit at the request of the General Deputy Assistant Secretary.

We concluded that Hough did not fully comply with Federal Regulations regarding the Community Development Block Grant Program and Empowerment Zone Program. These problems occurred prior to the establishment of Hough's current internal control system. After March 1, 1996, Hough improved its system of internal controls when it hired a local certified public accounting firm as its fiscal officer. Hough also hired a checking service to make all of Hough's payments and provide cash analysis and reports.

Hough did not use \$29,381 of CDBG funds for authorized purposes

Hough received Community Development Block Grant money totalling \$29,381 but did not use the money for its authorized purposes. The Office of Management and Budget requires Federal funds to be used only for authorized purposes. Hough received the funds from the City of Cleveland to be paid to third parties but did not pass along the money to the intended recipients. Hough did not maintain an adequate system of internal controls to assure third parties were paid. Thus, Hough did not use the money for its intended purpose.

Payments of \$13,274 were not supported by adequate documentation

Between January 1, 1995 and December 31, 1996, Hough made payments from Community Development Block Grant funds totalling \$13,274 which were not supported by adequate documentation. Contrary to Office of Management and Budget requirements, Hough did not maintain an adequate system of internal controls to assure that payments were properly supported, thus increasing the risk of loss or misuse of funds. As a result of the unsupported disbursements, HUD had less assurance that Hough paid only for eligible and reasonable costs.

Recommendations

We recommend that HUD's Ohio State Office's Director of Community Planning and Development requires the City of Cleveland's Department of Community Development to provide a proper accounting or reimburse the Community Development Block Grant Program for the \$29,381 Hough received but did not pass along to third parties. In addition, we recommend that the City of Cleveland provide support for

the \$13,274 of unsupported costs or reimburse the Block Grant Program from non-Federal funds.

We provided our draft findings to the Director of Community Development for the City of Cleveland and Hough's Interim Executive Director. On August 27, 1997, we held an exit conference with the City of Cleveland and Hough.

The City of Cleveland provided written comments to our draft findings. The written responses were considered in preparing the report. Excerpts from the responses are included after each finding and in their entirety in Appendix B. Because of the volume, we did not include attachments that the auditee provided with the response. We provided copies of all the attachments to the Director of Community Planning and Development in HUD's Ohio State Office.

Table of Contents

Management Memorandum	i
Executive Summary	iii
Introduction	1
Findings	
1 Hough Did Not Use HUD Money of \$29,381 for Authorized Purposes	3
2 Payments of \$13,274 Were Not Supported by Adequate Documentation	9
Internal Controls	13
Follow Up On Prior Audits	15
Appendices	
A Schedule of Questioned Costs	17
B Auditee Comments	19
C Distribution	29

(THIS PAGE LEFT BLANK INTENTIONALLY)

Introduction

Hough Area Partners In Progress, Inc. was established in 1981 to provide greater coordination to advocacy and social service providers in the Hough neighborhood. On March 23, 1983, Hough was incorporated in the State of Ohio as a not-for-profit corporation. The Internal Revenue Service recognizes Hough as exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

Hough was governed by a 26-member Board of Trustees and had a staff of 19 full-time employees as of January 1, 1997. Through the City of Cleveland, Hough received Community Development Block Grant funds and Empowerment Zone funds.

Hough's Community Development Block Grant activities included second mortgage assistance to qualified home buyers in the New Construction Program and beautification of the Hough neighborhood in the Cityworks Program. Hough also received Community Development Block Grant Program money for the Summer Tutorial Program, Paint Program, and Youth Build Program.

In addition, Hough received a \$350,000 Empowerment Zone grant from the City of Cleveland in November 1995. The grant was for expenses necessary to operate the Empowerment Zone activities at Hough. These activities included job creation, Empowerment Zone resident planning, and commercial and community economic development technical assistance and planning.

The City of Cleveland suspended the funding to Hough in March 1996 because of the back taxes Hough owed to various taxing agencies. As a result, the City of Cleveland and Hough entered into a probationary agreement to restore the funding. The probationary agreement required Hough to enter into repayment agreement plans with taxing agencies to which it owed back taxes. The City restored the funding in May 1996 when Hough executed repayment plans with the taxing agencies. In addition, the probationary agreement required Hough to provide the City two appointments to Hough's Board of Trustees, prepare a debt reduction plan to repay all delinquent debts, complete a financial audit for fiscal year 1995, and hire key management staff.

The City of Cleveland's official representative was Terri Hamilton, Director of the Department of Community Development. Hough's Interim Executive Director was Curtis Shaw. The books and records were located at 8610 Hough Avenue, Cleveland, Ohio.

Audit Objectives

The objectives of our audit were to determine whether Hough accounted for and used Community Development Block Grant funds and Empowerment Zone funds in accordance with Federal regulations.

Audit Scope and Methodology

We performed our on-site work between January 1997 and July 1997 at the City of Cleveland and Hough. To assess

Hough's internal controls, we interviewed City of Cleveland's staff and Hough's staff. In addition, we obtained and reviewed grant agreements, confirmed Hough's bank balances, and reviewed records from Hough's checking service.

At Hough, we performed a review to account for 100 percent of the checks issued by Hough in 1995 and 1996. We also examined a judgmentally selected sample of checks for proper signatures. We traced a judgmentally selected sample of cancelled checks to supporting documentation. In addition, we obtained documentation from a private lender, the Homeowners' Association, and Hough's contractor for the development and construction of a housing project.

We conducted our audit in accordance with generally accepted auditing standards.

The audit covered the period from January 1, 1995 through December 31, 1996. We extended the audit period as necessary. We provided a copy of our report to Cleveland's Director of Community Development and Hough's Interim Executive Director.

Hough Did Not Use \$29,381 of HUD Money for Authorized Purposes

Hough received Community Development Block Grant money totalling \$29,381 but did not use the money for its authorized purposes. The Office of Management and Budget requires Federal funds to be used only for authorized purposes. Hough received the funds from the City of Cleveland to be paid to third parties but did not pass along the money to the intended recipients. Hough did not maintain an adequate system of internal controls to assure third parties were paid. Thus, Hough did not use the money for its intended purpose.

HUD Requirements

Office of Management and Budget Circular A-110, Standards for Financial Management Systems, Attachment F, Section 2, states that recipients' financial management systems shall provide for effective control over and accountability for all money, property, and other assets. Recipients shall adequately safeguard all such assets and shall assure that they are used solely for authorized purposes.

Hough received \$29,381 but did not use the money for authorized purposes

Hough received \$29,381 from the City of Cleveland, but did not use the money for authorized purposes. Hough had received all the required money under the grant but did not pass some of the money to third parties as required. The following table summarizes the money Hough did not use for authorized purposes.

Non-Payment to Third Parties	
Renaissance Place Homeowners Association	\$25,000
Cityworks	<u>4,381</u>
Total	<u>\$29,381</u>

Hough owed \$25,000 to a Homeowners' Association in the New Construction Program

Hough owed \$25,000 to the Renaissance Place Homeowners' Association for five homes closed from January 1995 through June 1995. Hough received the money from the City of Cleveland and deposited it into its general operating account during 1995. However, Hough did not pay the Homeowners' Association.

The City of Cleveland began a construction program in 1992 to provide incentives for individuals to move to the City of Cleveland. The program included selling lots and financing mortgages at a one percent discount through participating banks. In addition, the City provided down payment assistance to qualified home buyers in the form of a second mortgage. A qualified home buyer in the Renaissance Place housing project could receive a maximum of \$20,000 in down payment assistance. The down payments were funded with Community Development Block Grant funds.

Of the \$20,000 the City provided for each house that closed in the Renaissance Place, Hough was to repay \$12,000 to the lender on its private loan. In addition, Hough was to distribute the remaining \$8,000 according to a letter agreement dated July 9, 1993. Hough was to pay \$5,000 to the Renaissance Place Homeowners' Association capital improvement fund and \$3,000 to repay a loan from a local initiatives support corporation.

Hough received 12 payments for Renaissance Place homes that closed from April 1994 through January 1996. Hough deposited the money it received into a general operating account. During this period, Hough failed to make five payments to the Homeowners' Association. As a result, Hough owed the Homeowners' Association \$25,000 as of July 8, 1997.

Hough did not pay \$4,381 to Cityworks Program groups

Hough did not pass on money totalling \$4,381 from the City of Cleveland that was designated for two street clubs that participated in the Hough area Cityworks Program in 1995. The program was funded with Block Grant money. The program provides matching grants to neighborhood street clubs for vacant lot improvements, beautification of the neighborhood, block watches and neighborhood safety patrols. The street clubs must match the City grant dollar for dollar.

The \$4,381 Hough received from the City of Cleveland included \$3,000 in November 1995 for one neighborhood

Internal controls were ineffective

street club and \$1,381 in December 1995 for another neighborhood street club. Hough deposited the \$4,381 into its general operating account in 1995. However, Hough still owed these neighborhood street clubs as of July 8, 1997.

We discussed the issue of money not being used for authorized purposes with the Interim Executive Director. However, the Interim Executive Director was not employed at Hough during this time period and therefore, did not know why the money was not used for authorized purposes. Knowledgeable officials left Hough, and we were not able to locate them for comment.

We concluded that Hough had inadequate systems of internal control and cash management during this time period. Hough did not maintain adequate systems to assure it properly accounted for all money received. The fiscal year 1994 independent audit and another report by a local certified public accountant dated October 31, 1995 cited several control deficiencies.

The fiscal year 1994 report stated that duties were not segregated, accounting records needed to be reconstructed, fixed assets were not accounted for properly, and purchasing procedures were not being followed. In addition, a certified public accountant firm's review of Hough's operations as of October 31, 1995 cited several internal control weaknesses: duties were not segregated, accounts payable were not properly classified, and employees' payroll withholdings were not paid timely. As a result of the inadequate controls, Hough did not pay money owed to third parties.

Because of these two reports on Hough's internal control weaknesses, Hough changed its procedures beginning March 1, 1996 and hired a local certified public accounting firm as its fiscal officer. Hough also hired a checking service to make all of Hough's payments. Our analysis and tests of the checking service's internal controls did not disclose any deficiencies. As a result of these changes, Hough is less likely to use money for other than authorized purposes.

Auditee Comments

[Our draft finding questioned \$73,000 owed to a contractor to complete the Renaissance Place housing project and \$99,175 in apparently duplicate payments.]

Based on the City's response, we deleted these issues from the finding.

Auditee Comments

The \$25,000 due the Renaissance Place Homeowners' Association was not funded using Federal or City administered funds. The City, however, does acknowledge that this debt is owed.

The \$25,000 due to the Homeowners' Association was to be paid out of the closing settlement of each house. The purchaser or builder was assessed the \$5,000 payment by adding the cost to the sales price of the lot (land) in the final purchase agreement. [The Federally-funded second mortgages] did not fund the \$5,000 initial assessment. When made aware of the debt owed to the Homeowners' Association:

- 1) The City installed a policy to issue co-payments checks to Hough and the Homeowner, requiring Hough to make the appropriate disbursement; and
- 2) On October 17, 1996, Hough paid an additional \$1,000 at the closing of the 17th house, reducing the total amount owed to the Homeowners' Association to \$24,000.
- 3) Village Capital Corporation, the private lender, entered into an agreement with Hough and the Homeowners' Association to increase the per unit payments due the Homeowners' Association at closing on the last three houses from \$5,000 to \$8,000.

OIG Evaluation of
Auditee Comments

We disagree that the funding source for the payments to the Homeowners' Association was non-Federal funds. Hough and the private lender supplemented their loan agreement in July 1993. The supplement clearly stated that \$5,000 of the second mortgages from the City were to be used to be paid to the Homeowners' Association to fund capital improvements. The second mortgages were funded with Community Development Block Grant money. In addition, the City did not provide documentation that the \$1,000 Hough paid on October 17, 1996 came from non-Federal funds. In our opinion, increasing the payments to the Homeowners' Association is not an allowable way for the City to repay the debt if the source of the payments is Federal Block Grant money. Our review found that the payments Hough made to the Homeowners's Association at closing for capital improvements were funded with Community Development Block Grant money. The debt should be repaid with non-Federal funds.

Auditee Comments

Federal Community Development Block Grant funds of \$4,381 were awarded and disbursed to Hough through contracts for the Cityworks Program. These funds were not paid to the Dunham Block Club (\$1,381) and Holyrood Avenue Street Club (\$3,000) in accordance with the contract.

Beginning in January 1997, the Department of Community Development was in communication with Hough representatives to seek repayment of the funds owed with non-federal funds. The City then conducted a thorough review of all Cityworks grants awarded to Hough for the period 1993-1996 and determined that all other grants disbursed had been paid appropriately. On May 15, 1997, the City provided a final report on this matter and found Hough in violation of its contract with the City.

On April 18, 1997, the Hough Board approved a resolution to repay the \$4,381 owed to the respective street clubs with non-federal funds as soon as such unrestricted funds became available to Hough. To date the funds have not been paid to the street clubs.

OIG Evaluation of
Auditee Comments

The City's comments indicate agreement with our finding that Hough owes \$4,381 to the two street clubs.

Recommendations

We recommend that the Director of Community Planning and Development, HUD Ohio State Office, requires the City of Cleveland Department of Community Development to:

- 1A. Direct Hough Area Partners In Progress to provide a proper accounting of the \$29,381 Hough received. If Hough cannot provide a proper accounting of the money, the City should pay with non-Federal funds:
 - \$25,000 to the Renaissance Place Homeowners' Association;
 - \$3,000 to the Holyrood Avenue Street Club; and
 - \$1,381 to the Dunham Block Club.

Payments of \$13,274 Were Not Supported by Adequate Documentation

Between January 1, 1995 and December 31, 1996, Hough made payments from Community Development Block Grant funds totalling \$13,274 which were not supported by adequate documentation, contrary to Office of Management and Budget requirements. Hough did not maintain an adequate system of internal controls to assure that payments were properly supported, thus increasing the risk of loss or misuse of funds. As a result of the unsupported disbursements, HUD had less assurance that Hough paid only for eligible and reasonable costs.

HUD Requirements

Office of Management and Budget Circular A-110, Standards For Financial Management Systems, Attachment F, Section 2, states that recipients' financial management systems shall provide for accounting records that are supported by source documentation.

Further, Office of Management and Budget Circular A-122, Cost Principles for Nonprofit Organizations, Attachment A, Section A, states that for a cost to be allowable, it must be adequately documented.

How We Selected Sample

Because of Hough's internal control weaknesses, it engaged a certified public accounting firm and a checking service firm effective March 1996. The accounting firm reviewed all invoices and designated the funds to be charged. The checking firm issued the checks and provided check registers and other analysis.

Between January 1, 1995 and December 31, 1996, Hough and its checking service issued checks, excluding payroll checks, totalling \$1,248,347. Hough itself directly issued checks totalling \$905,117 and its checking service issued checks totalling \$343,230. Hough issued all checks from January 1, 1995 through February 1996. The checking service issued checks starting in March 1996, except that Hough continued to issue a limited number of checks to pay tax obligations and other infrequent bills needing a fast turn-around time.

We limited our detailed tests to checks Hough itself issued. We analyzed and tested the checking service's system of

internal controls and found no deficiencies. Therefore, we did not include the checking service's payments in our expanded sample. Of the \$905,117 Hough paid directly to vendors and other second parties, we judgmentally selected and reviewed 183 payments totalling \$611,683, or 68 percent of the total dollars paid.

Hough had no support for payments of \$13,274

Hough made payments totalling \$13,274 without documentation such as invoices, receiving reports, or other documents to support the payments' eligibility. The payments were made during 1995. The payees included a developer, an annuity company, and persons paid from the Summer Tutorial Program. Without supporting documentation, we could not determine the purpose of the payments. The following schedule shows the unsupported payments.

<u>Category</u>	<u>Amount</u>
Home developer	\$10,000
Annuity company	2,020
Summer Tutorial Program	<u>1,254</u>
Total	<u>\$13,274</u>

We provided Hough's Interim Executive Director with the list of unsupported payments on June 16, 1997. In addition, we provided the list to the City of Cleveland's Department of Community Development. The Interim Executive Director provided this list to the Chairman of the Board of Trustees.

Hough's system of internal controls were inadequate

Prior to March 1, 1996, Hough did not have an adequate system to control payments. The fiscal year 1994 independent audit and another report by a local certified public accountant dated October 31, 1995 cited several control violations (see Finding 1). Hough's weak internal controls reduced HUD's assurance that Hough paid for only eligible and reasonable costs.

Because of these two reports on Hough's internal control weaknesses, Hough changed its procedures beginning March 1, 1996 (see Finding 1). As a result of these changes, Hough is less likely to make payments without the proper documentation.

Auditee Comments

City of Cleveland staff have researched our records and can provide supporting documentation for 20 of the 58 checks questioned in the Draft Audit Finding #2. The specific payments for which we have related documentation are for the Paint, Home Weatherization Assistance, Summer Tutorial and Cityworks Programs. We are continuing to research our files for additional supporting documentation, but at present cannot confirm that all 58 checks identified were in fact reimbursed with federal funds.

**OIG Evaluation of
Auditee Comments**

Based on the information provided in the City's response, we reduced the amount of unsupported payments from Federal funds to \$13,274. Our review of Hough's records showed the payments were made with Community Development Block Grant funds.

Recommendations

We recommend that the Director of Community Planning and Development, HUD Ohio State Office, requires the City of Cleveland Department of Community Development to:

- 2A. Direct Hough Area Partners In Progress to provide invoices, receipts, or other documentation supporting the eligibility and reasonableness of the \$13,274 paid without adequate documentation.
- 2B. Reimburse the Block Grant program from non-federal funds for all amounts that cannot be supported, such as invoices, receiving reports, or other documents to support the payments' eligibility.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Internal Controls

In planning and performing our audit, we considered the internal controls of the management of Hough Area Partners In Progress, Inc. to determine our auditing procedures and not to provide assurance on internal controls. Internal controls consist of the plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations and policies; that resources are safeguarded against waste, loss and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Relevant Internal Controls

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

- Management philosophy and operating style;
- Oversight body;
- Methods of assigning authority;
- Accounting system and controls;

A significant weakness exists if internal controls do not give reasonable assurance that the entity meets goals and objectives; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Significant weaknesses were corrected during the audit period

Based on our review, we concluded that the following items were significant weaknesses:

- Accounting system and control. Hough received \$29,381 from the City of Cleveland but did not pass along the money to third parties, as required (see Finding 1). In addition, Hough paid \$13,274 without adequate documentation (see Finding 2).

These problems occurred prior to the establishment of Hough's current internal control system. After March 1, 1996, Hough improved its system of internal controls when it hired a local certified public accounting firm as its fiscal officer. Hough also hired a checking service to make all of Hough's payments and provide cash analysis reports.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Follow Up On Prior Audits

This is the first OIG audit of the City of Cleveland funds provided to Hough, a non-profit subrecipient. Hough did not obtain an independent auditor's report for fiscal years ended 1995 or 1996. The fiscal year 1994 independent public accountant audit revealed several internal control deficiencies. It stated that duties were not segregated, accounting records needed to be reconstructed, fixed assets were not accounted for properly, and purchasing procedures were not being followed. As a result, Hough changed their procedures beginning March 1, 1996 and hired a local certified public accounting firm as Hough's fiscal officer. Hough also hired a bookkeeping service to make all of Hough's payments. Our analysis and tests of the bookkeeping service's internal controls did not disclose any deficiencies.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Schedule of Questioned Costs

<u>Recommendation Number</u>	<u>Type of Questioned Cost</u>	
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>
1A	\$29,381	
2A		\$13,274

- 1/ Ineligible costs are costs charged to a HUD-financed or insured program or activity which the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.
- 2/ Unsupported costs are amounts charged to a HUD-financed or insured program or activity whose eligibility cannot be determined at the time of audit since such costs were not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. These costs require a future decision on the part of HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Auditee Comments

City of Cleveland

Michael R. White, Mayor

Department of Community Development

Terri D. Hamilton, Director
601 Lakeside Avenue, Room 320
Cleveland, Ohio 44114-1070
216/664-4000

August 26, 1997

Mr. James J. Sobota, Senior Auditor
U.S. Department of Housing and Urban Development
Office of Inspector General for Audit, Midwest

200 North High Street, Room 334
Columbus, Ohio 43215-2499

Dear Mr. Sobota:

Attached is the City of Cleveland, Department of Community Development's response to the Draft Audit Finding # 1, concerning the Office of the Inspector General for Audit, U.S. Department of Housing and Urban Development review of Hough Area Partners in Progress, Inc. (HAPP) and additional information to Draft Audit Finding #2. By this response, the City does not intend to waive any rights it has regarding any HUD Audits and Findings.

Specifically, this response indicates the City agrees with certain conclusions reached by your review. Beginning in August of 1995, when HAPP's extensive financial problems became apparent, the City began working with the Agency to accurately determine its financial condition. In October, 1995, the City hired two accounting firms to review HAPP's fiscal books. Based on the results of that report and evidence of larger amounts of unpaid debts, the City stopped all payments for City and federally funded programs and required the agency to undertake specific fiscal and management controls as a condition for the resumption of funding. A copy of the correspondence to HAPP indicating the City's concerns regarding its financial condition and the subsequent Probationary Agreement, entered into on May 15, 1996, is attached. (Attachment 1)

Further, this response provides additional information and supporting materials obtained from City files regarding the use of federal and non-federal funds by HAPP for activities cited in the Draft Audit Findings 1 and 2.

My staff and I have invited representatives from HAPP to attend the exit interview conference you requested for the purpose of reviewing the Draft Audit Findings. The City reserves the right to amend this response based on additional information that may be identified from our files between now and the time of the meeting on Wednesday, August 27th.

An Equal Opportunity Employer

HAPP
August 26, 1997
Page 2

If you have any questions or need further information, please contact Terry Ross, Commissioner of Administrative Services, at 216-664-4009.

Sincerely,
Terri D. Hamilton, Director
Department of Community Development

cc: Sharon Sobol-Jordan
Terry Ross
Franc Glavan
Tony Shah

IGA-HAPP

8/26/97

Grantee's Responses

1A. Direct Hough Area Partners In Progress, Inc. (HAPP) to provide a proper accounting for the \$52,907 Hough received.

- \$4,381 of federal Community Development Block Grant funds were awarded and disbursed to HAPP through contracts for the Cityworks Program. These funds were not paid to the Dunham Block Club (\$1,381) and Holyrood Avenue Street Club (\$3,000) in accordance with the contract.

Beginning in January, 1997, the Department of Community Development was in communication with HAPP representatives to seek repayment of the funds owed with non-federal funds. The City then conducted a thorough review of all Cityworks grants awarded to HAPP for the period 1993-1996 and determined that all other grants disbursed had been paid appropriately. On May 15, 1997, the City provided a final report on this matter and found HAPP in violation of its contract with the City.

On April 18, 1997, the HAPP Board approved a resolution to repay the \$4,381 owed to the respective Street Clubs with non-federal funds as soon as such unrestricted funds became available to HAPP. To date, the funds have not been paid to the Street Clubs.

Copies of the January 24, February 6, and May 15, 1997 correspondence regarding this audit finding are attached. Also attached is a copy of the HAPP Board resolution approving the payment of funds owed to all Street Clubs. (Attachment 2)

- \$25,000 due to the Renaissance Place Homeowners' Association and \$23,526 (+ \$15,410 retainage) due to Ty Incorporated were not funded using federal or City administered funds. The City, however, does

acknowledge that these debts are owed and provides the following details regarding this audit finding.

Renaissance Place, a 20-unit housing subdivision, was assisted with federal Community Development Block Grant funds and City urban renewal and neighborhood development bonds. The total development cost for the land acquisition and site development component of the project was originally estimated at \$550,000. Those project costs were later increased to \$591,977.70 due to increased (actual) costs over estimates.

The City funding to the project consisted of three types of assistance:

- A. Grants for certain land acquisition, relocation assistance, demolition and site preparation. The original grant amount was \$190,000, executed in December, 1992, and later amended to a total of \$220,000, executed in July, 1993. The funding source for this contract was City neighborhood development bonds and not federal funds. A copy of the Ordinance is attached. (Attachment 3) The breakdown of expenditures is the following:

	\$220,000
	Contract
Land Acquisition	\$ 99,789
Architectural/Engineering	21,894
Demolition	27,604
Other/Relocation	8,315
Legal/title	11,762
Site Improvement	<u>50,636</u>
	\$220,000

- B. City funded infrastructure paid directly to the public improvements contractor. HAPP was not a party to this contract.
- C. Second Mortgage loans to the individual homeowner's through HAPP in the amount of \$20,000 per house to assist with the financing of the homes.

The \$25,000 due the Homeowners' Association was to be paid out of the closing settlement of each house. Per

the Declaration of Covenants and Restrictions Renaissance Place Homeowner's Association, Incorporated , executed May 6, 1993, Volume 93 - 06183, Section 1-Initial Assessment requires the purchaser or builder to contribute to the Association an initial non-refundable assessment of \$5,000 for the purpose of making improvements to the Common (Area) Properties. The purchaser or builder was assessed the \$5,000 payment by adding the cost to the sales price of the Lot (land) in the final purchase agreement.

The City second mortgages disbursed to the individual Homeowners' through HAPP, and later through HAPP and the title company, did not fund the \$5,000 initial assessment. The federally funded second mortgage loans were provided to assist in the overall financing of the home.

When made aware of the debt owed to the Homeowner's Association:

- 1)The City installed a policy to issue co-payments checks to HAPP and the homeowner, requiring HAPP to make the appropriate disbursement; and
- 2)On October 17, 1996, HAPP paid an additional \$ 1,000 at the closing of the 17th house, reducing the total amount owed to the Homeowners' Association to\$24,000.
- 3)Village Capital Corporation, the private lender, entered into agreement with HAPP and the Homeowner's Association to increase the per unit payments due the Homeowner's Association at closing on the last three houses from \$5,000 to \$8,000.

The City and HAPP have acknowledged the original amount of \$25,000 owed to the Homeowners' Association and that amount was included on the summary of delinquent debts HAPP listed as outstanding obligations referenced in the Probationary Agreement. To date, HAPP has not submitted a plan to repay the balance of \$15,000 owed to the Homeowners' Association once the 20th house closes.

- \$23,526 due to Ty Incorporated for site preparation work at Renaissance Place has been verified as work inspected, approved and completed. This work was not invoiced to the City or the private lender and remains unpaid. Because the City did not pay for this work nor was the total amount of the Ty Incorporated contract to be paid by the City funds, the lack of payment is not a direct misuse of federal funds. Because the Renaissance project was assisted with federal funds and remains incomplete, the City agrees that this cost and the remaining amount to complete the project should be undertaken by HAPP in accordance with its contract with the City.

1B. Reimburse the Community Development Block Grant Program the \$49,474, with non-Federal money, needed to complete the Renaissance Place Housing Project.

- The estimated \$49,474 required to complete the site preparation work should actually total \$51,310. Ty Incorporated originally contracted to perform the work for a contract amount of \$190,000. Payments made to date to Ty Incorporated by HAPP total \$115,164. The remaining \$51,300 owed includes: \$35,900 not yet billed under the contract and \$15,410 for retainage held back to date and not yet paid. The amount due to complete the site work should not be reimbursed to the Community Development Block Grant Program because it was not funded by the City. The funds should be paid by HAPP to the contractor that completes the work.

In the City's August 22, 1997 letter to HAPP's Board President, Willie Starkey, we asked for a response to all audit findings including how HAPP will pay these additional funds. The City has requested a response by September 3rd.

Based on the City's records, we are aware of an additional \$41,977.70 in costs not originally budgeted and therefore considered cost overruns that have already been paid by HAPP. These additional costs are

in the categories of relocation, property acquisition, real estate taxes and site preparation.

1C. Reimburse the Community Development Block Grant Program, the \$99,175, with non-Federal money in, duplicate payments.

The source of the questioned costs of \$99,175 are local neighborhood development bond funds and not federal funds. The City agrees that on three specific payments totaling \$99,173.96, there was double billing of invoices to both Village Capital Corporation (VCC), the private lender, and the City of Cleveland, the provider of grant funds for the land acquisition and site development phase of the project. The specific payments include:

		Surety Title	
<u>Land Acquisition</u>	<u>\$47,538.96</u>		
Ralph C. Tyler			
	<u>3/10/93</u>		
		<u>Engineering</u>	<u>1,000.00</u>
Ty Incorporated			
	<u>10/29/93</u>		
		<u>Site Improvement</u>	<u>50,635.94</u>
	<u>8/17/94</u>		

The City disbursed on a reimbursement basis, as is typical for most CDBG awards through the Department of Community Development. In order for HAPP to obtain funds to pay the cost of land acquisition, demolition, site preparation and other eligible City grant funded activities, the agency had to obtain funds from a separate non-federal source.

To pay for the service or activity in this case, VCC extended two (2) private loans, \$220,000 and \$41,500 respectively, to HAPP for the purpose of acquisition of land; demolition of certain structures; site preparation; landscaping; and installation of parking areas. The stated repayment of the VCC loan was a release payment, being a portion of the sales proceeds from each lot sold.

The original \$220,000 loan has been repaid to VCC through closings on 17 houses. The \$41,500 loan is being repaid out of the last 3 houses.

Related documentation shows the grant disbursements made were for eligible activities. The City has now requested HAPP to fully document its use of the VCC funds after to the City's disbursement of the grant funds for the payments totaling \$99,173.96.

A copy of the City's schedule of payments under the \$220,000 grant is attached. (Attachment 4)

1D. Assure that Hough only drawdown the amount Of money for which services have been completed

The City's policy related to the use of federal funds is to reimburse agencies for services provided and costs already incurred. The City follows this practice with HAPP and we monitor very closely all requests for drawdowns and supporting documentation submitted by the agency.

The City does, however, acknowledge that HAPP has had poor bookkeeping and accounting procedures as evidenced in the 1994 Audit, subsequent fiscal reviews and its current financial condition. Contributing causes to the poor financial condition of the agency extend beyond its funding and use of federal funds.

The City has taken additional steps with HAPP to insure appropriate fiscal and management controls are in place for all funding received by the agency. The following lays out the specific steps taken:

- In December, 1995, the City hired Coopers & Lybrand and Dingas & Daga, certified public accounting firms, to prepare interim financial statements for 1995 and statements of activity for each project, review accounting systems, procedures, and controls, and to make recommendations for changes. A copy of the final report is attached. (Attachment 5)
- In February, 1996, HAPP hired Dingas & Daga to perform its day-to-day accounting needs. Total responsibilities include the preparation of periodic reports to funding sources and monthly financial statements; preparation and review of on-going cash

receipts and disbursements; and development of budgetary controls. In addition, Dingas & Daga closed the 1995 and 1996 fiscal books in preparation for the financial audit.

- As a result of the Probationary Agreement executed with HAPP in May, 1996, the following actions have been taken:

*HAPP entered into repayment agreements with all taxing authorities and all tax liabilities are up to date;

*HAPP staff is providing to the HAPP Board and the City monthly financial reports as well as copies of canceled checks for payments of taxes;

*HAPP staff submits monthly reports on the status of outstanding debts;

*The City hired a certified public accounting firm, Krasney Polk Friedman and Fishman, to complete the 1995 and 1996 audits.

It is the City's intent to continue to monitor HAPP closely throughout the term of the Probationary Agreement that will continue through November, 1997, and past that date as needed, based on the fiscal and management controls maintained by the agency.

Finding #2

The following response is provided to supplement the initial response provided to you on August 7, 1997. Since that time, City staff have researched our records and can provide supporting documentation for 20 of the 58 checks questioned in the Draft Audit Finding 42. The specific payments for which we have related documentation are for the Paint, Home Weatherization Assistance, Summer Tutorial and Cityworks Programs. Photocopies of this documentation for checks totaling \$15,309.64 are provided for your review. (Attachment 6)

We are continuing to research our files for additional supporting documentation, but at present cannot confirm that all 58 checks identified were in fact reimbursed with federal funds.

City staff are presently researching the following checks and will attempt to provide additional information at our meeting on Wednesday, August 27th:

Check #	Payee Amount	Check
3574	Capri Homes	\$5,000.00
3624	Capri Homes	5,000.00
4276	Gennoris Williams-Heard	1,800.00
5103	AT&T	629.00
5120	Builder's Square	741.65
5150	Meritech	525.00

Summary

In Summary, the City agrees with certain Draft Audit Findings prepared by the Office of the Inspector General and certainly agrees that HAPP has had significant fiscal and management problems, as well as the lack of financial controls. Specific steps have been undertaken as a result of the Probationary Agreement between the City and HAPP to correct the bookkeeping and accounting deficiencies, and with the hiring of the new executive director, there is an expectation that the management oversight will improve as well. However, close monitoring and the completion of the fiscal audits for 1995 and 1996 will be required to determine the true financial condition of HAPP and whether the specific steps taken are adequate.

Distribution

Secretary's Representative, Midwest
Field Comptroller, Midwest
Director, Community Development, City of Cleveland
Acting Director, Community Planning and Development, Ohio State Office
Director, Field Accounting Division, Midwest
Assistant to the Deputy Secretary for Field Management, SDF (Room 7106)
Comptroller/Audit Liaison Officer, Office of Housing, HF, (Room 5132) (3)
Acquisitions Librarian, Library, AS (Room 8141)
Chief Financial Officer, F (Room 10164) (2)
Deputy Chief Financial Officer for Finance, FF (10164) (2)
Director, Housing and Community Development Issue Area, U.S. GAO, 441 G Street, NW,
Room 2474, Washington, DC 20548 Attn: Judy England-Joseph
The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs, United
States Senate, Washington, DC 20515-4305
The Honorable Fred Thompson, Ranking Member, Committee on Governmental Affairs, United
States Senate, Washington, DC 20515-4305
Mr. Pete Sessions, Government Reform and Oversight committee, Congress of the United
States, House of Representatives, Washington, DC, 20510-6250
Jacquie M. Lawing, Acting Assistant Secretary for Community Planning and Development
Cindy Sprunger, Subcommittee on General Oversight and Investigations, Room 212, O'Neill
House Office Building, Washington, D.C. 20515