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TO: Joseph K, Aversano, Director, Community Planning and Development Division,
Virginia State Office, 3FD

FROM: Edward F. Momorella, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: City of Norfolk
Community Development Block Grant Program
Norfolk, Virginia

We performed an audit of the City of Norfolk (Grantee) Community Development Block Grant (CDBG) Program. Our report contains four findings requiring follow up action.

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.

We appreciate the cooperation of your staff during this audit. If you have any questions, please contact Allen Leftwich, Assistant District Inspector General for Audit at (215) 656-3401.

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Executive Summary

The purpose of the audit was to determine whether the City of Norfolk carried out its CDBG program in an economical, efficient, and effective manner and complied with CDBG Program requirements, laws, and regulations.

Our review showed that the Grantee generally administered an effective program. However, we determined that the City did not have adequate controls in place to ensure compliance with regulations and effectively manage programs administered by its subgrantee.



Specifically, the review disclosed:

- The subgrantee did not effectively administer its property acquisition program. Activity designed to benefit low and moderate income beneficiaries were instead provided to persons whose annual income exceeded eligibility thresholds. As a result, program results were not achieved and intended program beneficiaries were deprived of \$766,057 of program resources.
- The subgrantee appeared to have charged unreasonably high staff and overhead costs to deliver rehabilitation, demolition and relocation activities. As a result, there were no assurances that funds designed to provide direct community benefits were maximized and expenditures totaling \$856,309 were reasonable.
- The subgrantee did not maintain adequate records for its property acquisition, rehabilitation and relocation activities. As a result, there were minimal assurances that funded activities were consistent with program goals and that excess relocation payments totaling \$82,368 were justified and reasonable.
- The Grantee has not adequately monitored its subrecipient. Consequently, HUD and the Grantee had minimal assurance that the subrecipient properly implemented HUD assisted programs, met intended program goals, and efficiently managed program resources.

We recommend that the Grantee reimburse the CDBG program for all ineligible costs and resolve unsupported costs; require the subgrantee to establish procedures to become more active in the property disposition eligibility determination process and obtain more documentation to support household income; perform a detailed study of the subgrantee's delivery cost procedures and timekeeping practices; require the subgrantee to maintain full and detailed records to support its acquisition, rehabilitation and relocation activity; and update and implement its subrecipient monitoring plan.

We presented five draft findings to the Grantee, subgrantee and HUD officials during the audit. We held an exit conference on January 6, 1999, and provided the Grantee, subgrantee and HUD officials a copy of the draft report containing four findings. The Grantee provided written comments to our findings and has taken steps to correct some of the reported deficiencies. The HUD Virginia State Office and the subgrantee, the Norfolk Housing and Redevelopment Authority, also provided written comments to our findings. We considered the responses in preparing our final report. We included excerpts from the Grantee's and subgrantee's responses in each finding and their complete comments as Appendix E and F.

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Abbreviations:

CDBG	Community Development Block Grant
CFR	Code of Federal Regulations
FY	Fiscal Year
HUD	Department of Housing and Urban Development
NRHA	Norfolk Redevelopment and Housing Authority
OIG	Office of the Inspector General
OMB	Office of Management and Budget

Introduction

Title I of the Housing and Community Development Act of 1974 as amended, established the CDBG program that provides grants to states and units of local governments to aid in the development of viable urban communities.

The City of Norfolk, Virginia (Grantee), was founded in 1682 and is governed by the City Council and City Manager. CDBG Program oversight is maintained by the Deputy City Manager and is administered through the Assistant City Manager for Planning and Physical Development and the Finance Department by the City Planning and Budget Bureaus. During the audit, the City Manager was James B. Oliver, Jr. and the Deputy City Manager was Darlene L. Burcham. The Grantee contracted with its prime subrecipient, the NRHA, to carry out the majority of its community development initiatives. The Executive Director of the NRHA was David H. Rice.

CDBG funding provided during recent program cycles were:

Fiscal Year	Grantee Total Funding	Contracted To Subgrantee
1997	\$ 7,427,000	\$ 6,132,932
1998	7,578,000	6,338,000
Total	\$15,005,000	\$12,470,932

The books and records were maintained by the Grantee at the City Hall Building and by the NRHA at 201 Granby Street, both in Norfolk, Virginia.

Audit Objectives, Scope
And Methodology

The focus of our review was to determine whether the City of Norfolk carried out its CDBG am in an economical, efficient, and effective manner and complied with CDBG Program requirements, laws, and regulations.

To achieve the audit objectives, we: (1) reviewed applicable Federal regulations and HUD guidelines; (2) tested program activities for compliance with CDBG requirements; and (3) examined records and files of the City, NRHA, and HUD and interviewed appropriate staff. We also inspected six completed and three pending rehabilitation projects and 39 CDBG acquired parcels.

The audit covered the period from September 1996 through August 1997. However, we expanded our period of review when appropriate. The audit site work was performed between September 3, 1997 through September 30, 1998.

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

Property Acquisition Activity Did Not Meet Low and Moderate Income National Objectives

The Grantee's subrecipient, the Norfolk Redevelopment Housing Authority (NRHA) did not have adequate procedures to ensure property acquired, improved and disposed of as part of its CDBG program met established national objectives. Acquisition activity designed to provide housing benefits to persons of low to moderate income were instead provided to persons whose annual income exceeded eligibility thresholds. The NRHA relied on real estate developers to ensure program objectives were met but did not monitor their efforts nor did they have an active role in the eligibility determination process. As a result, intended program results were not achieved and the NRHA spent CDBG funds totaling \$675,831 and \$90,226 for ineligible and unsupported activities, respectively.

Criteria

24 CFR 570.208(a)(3) states that Housing activities are "An eligible activity carried out for the purpose of providing or improving permanent residential structures which, upon completion, will be occupied by low and moderate income households. This would include, but not necessarily limited to, the acquisition or rehabilitation of property by the recipient, a subrecipient, a developer..."

24 CFR 570.506 provides "Each recipient shall establish and maintain sufficient records to enable the Secretary to determine whether the recipient has met the requirements of this part. At a minimum, the following records are needed: ... (b) Records demonstrating that each activity undertaken meets (a national objective)... Such records shall include the following information:

- (1) For each activity determined to benefit low and moderated income persons, the income limits applied and the point in time when the benefit was determined...
- (4) For each activity carried out for the purpose of providing or improving housing is determined to benefit low and moderate income persons:... (iii) For each unit occupied by a low and moderate

income household, the size and income of the household;”

24 CFR 570.3 defines “Household” as:

“...all the persons who occupy a housing unit. The occupants may be a single family, one person living alone, two or more families living together, or any other group of related or unrelated persons sharing living arrangements.”

24 CFR 570.3 also defines a low and moderate household as a household having an income equal to or less than the Section 8 low income limit established by HUD.

Background

A large portion of the CDBG funded activity conducted by the NRHA involved the acquisition of property in designated conservation and redevelopment project areas. Depending on the parcel, additional program funds may have been spent to demolish and clear existing structures. These properties were generally sold to real estate development companies at less than fair market value. Once acquired from the NRHA, the developer constructed a new house or rehabilitated an existing unit and then sold the improved property. During FY 1996 and 1997, the NRHA sold 45 parcels that were resold by developers. Our review included a review of 52 disposition actions. These 52 parcels cost the program about \$1.7 million and generated approximately \$428,000 in disposition proceeds.

Low and Moderate
Income Objectives Not
Met

The NRHA did not have procedures to monitor their property disposition activity to ensure that recipient’s income were adequately verified and low and moderate income objectives were achieved. Of the 52 parcels acquired with CDBG funds and sold during the audit period, 44 were bought and sold under low and moderate income program objectives. We reviewed disposition files and analyzed recipient income documentation for these 44 CDBG funded disposition actions to determine if program objectives were met. Our review showed that at least 11 of the 44 dispositions¹ did not meet program goals. Our review also showed that in 3 cases, program results were undeterminable since income documentation was not

¹ As stated later in this finding, recipient income was based on self certified income amounts which were not independently verified.

available. Property acquired to ultimately provide housing benefits to persons with low to moderate incomes were instead provided to persons whose annual income exceeded eligibility thresholds. For those cases where recipient income data was available, review results are summarized as follows:

Parcel	Project	Income Exceeding Limits
621	West Ocean View	\$23,012
189	Park Place	20,216
850	Berkely III	15,568
618	West Ocean View	13,450
620	West Ocean View	13,250
625/4	West Ocean View	7,600
77	Park Place	7,250
625/2	West Ocean View	7,223
612	West Ocean View	6,450
155B	Park Place	1,760
617	West Ocean View	1,218

Additionally, although low and moderate income eligibility needed to be established, income documentation was not available for three parcels; 613 and 622 West Ocean View and 104A Park Place.

Grant funds totaling \$675,831 were spent to acquire (net of proceeds) and improve the eleven parcels that were ultimately provided to persons whose income exceeded low and moderate income limits. These costs clearly did not satisfy program goals and are therefore ineligible. Similar costs amounting to \$90,226 were expended for the three cases where recipient income was not substantiated; and accordingly, are unsupported.

Developers Not Monitored

Once acquired properties were sold to real estate developers, the NRHA did not actively monitor developer initiatives to secure low and moderate income recipients. Although the deed of trust transferring property from the NRHA to the developers contained restrictive covenants requiring low and moderate income occupancy, the NRHA did not establish any procedures to ensure compliance. According to responsible personnel, the NRHA was not

involved in the eligibility determination process because the property was disposed of and they relied on the developers to meet low and moderate income objectives. Had the NRHA established and implemented procedures to monitor developer program compliance and been involved in the income verification process, those recipients with income exceeding eligibility limits would have been apparent and benefits could have instead been provided to persons for which the program was intended.

Household Income Not Adequately Verified

Documentation used to verify recipients household income was not adequate. Although income documentation was available for 41 of the 44 parcels bought and disposed of under low and moderate income objectives included in our review, it was not adequately verified in 32 of the 44 cases. Documentation supporting recipient income was insufficient because the NRHA did not require independent, third party verification of household income. In these 32 cases, the only record contained in the files was the recipient's self-certified statement as to the household annual income. To assure applicants are providing accurate information, independent income verification from outside sources should be obtained and used to substantiate household income and to validate low and moderate income program eligibility.

Auditee Comments

The Grantee, through its subrecipient, acknowledged that the beneficiary annual household income for the 14 cases cited in the finding exceeded low and moderate income limits. The Grantee further stated that it will strengthen its management procedures to ensure low and moderate income objectives are achieved by ensuring that:

- the BNO designation and funding source for all property is accurately identified and documented prior to commencing sales negotiations.
- all files relating to property acquired with a low and moderate income objectives will contain the supporting documentation used to determine income eligibility.
- contracts with real estate developers are amended to include provisions that would prohibit the transfer of property until sufficient evidence has been provided to

substantiate that the proposed occupant is income-eligible.

- independent, third party verification of household income is secured to substantiate income eligibility.
- a policy is drafted and approved by HUD that sets forth the parameters and guidelines for determining beneficiary eligibility.

As an alternative to repaying the CDBG Program the \$766,057 in ineligible and unsupported costs, the Grantee indicated that steps have been initiated to reclassify these costs to a slum and blight national objective. The Grantee has used HUD change of use provisions and initiated the City's citizen participation plan in support of this effort. The Grantee noted that this action will not adversely affect the City's statutory requirement of providing 70 percent low and moderate income benefits.

OIG Evaluation of Auditee Comments

The Grantee's stated actions to strengthen acquisition procedures and the accomplishment of low and moderate income objectives meets the intent of recommendations 1B and 1C.

We do not agree with the Grantee's use of HUD's change of use provisions as an alternative for paying back to the program the \$766,057 in ineligible and unsupported costs. 24 CFR 570.505(a) states that a Grantee may not change the use or planned use of any such property from that for which the acquisition was made unless the recipient provides affected citizens with notice of, and an opportunity to comment on the proposed change and the new use of the property meets a national objective.

Because the 14 cases cited in the finding represent completed actions, giving affected citizens an opportunity to comment on any proposed change in use is meaningless. Further, to broadly reclassify these acquisitions to a slum and blight national objective is not appropriate unless, on a case-by-case basis, sufficient documentation is available to support the assignment of the objective at the time of acquisition. As discussed in the finding, low and moderate income objectives were not realized because NRHA officials

relied on developers to make sure income-eligible participants received benefits and were not actively involved in the eligibility determination process. In our opinion, the change of use provisions were not intended to be used as a vehicle to effect changes as a result of inadequate management of property acquisition and disposition activity. Accordingly, our recommendation to pay the program back the ineligible and unsupported costs of \$766,057 still stands.

Recommendations

We recommend the Grantee:

- 1A. Repay the program \$675,831 for ineligible grant expenditures and properly justify or repay the unsupported expenditures of \$90,226.
- 1B. Ensure the NRHA establishes procedures that require a more active role in the eligibility determination process for property disposition actions. At a minimum, procedures should contain:
 - a monitoring plan designed to evaluate developer efforts to secure income eligible recipients.
 - enforcement provisions designed to hold real estate developers accountable for meeting low to moderate income objectives.
- 1C. Require independent, third party income verifications be obtained to substantiate household income for purposes of determining low and moderate income eligibility.

Delivery Costs Charged to the CDBG Program Were Excessive

CDBG activities administered by the subgrantee (NRHA) have unreasonably high delivery costs associated with their implementation. A review of FY 1997 CDBG expenditures showed that \$1.49 million was spent for providing direct rehabilitation, demolition, and relocation benefits to the community while \$1.23 million or 82 percent was spent on related staff and overhead costs to deliver these three activities. HUD guidance suggests that delivery cost percentages exceeding 25 percent are unusually high and should be evaluated. NRHA officials believed that the delivery costs charged to the program were reasonable since the CDBG funding was leveraged with other funding sources. However, the NRHA has not performed a detailed analyses to determine the reasonableness of delivery costs. As a result, there were no assurances that CDBG funds designed to provide direct community benefits were maximized and used efficiently to meet national objectives.

Criteria

24 CFR 570.206 states that staff and overhead costs directly associated with the implementation of an eligible CDBG activity are allowable as part of the activity's total costs. These costs are referred to as "activity delivery costs".

24 CFR 570.200(a)(5) prescribes that costs incurred, whether charged on a direct or an indirect basis, must be in conformance with OMB Circular A-87. The circular stipulates that to be eligible under Federal awards, costs must be necessary and reasonable for the proper and efficient performance and administration of Federal awards. The circular also defines direct costs as those that can be identified specifically with a particular final cost objective. Employee compensation is chargeable to Federal awards as a direct cost only to the extent of the time devoted and identified as specific to the performance of those awards.

HUD Handbook 6510.2 directs the use of HUD form 4949.5, "Rehabilitation Activities Form" to provide information on rehabilitation activities carried out with CDBG funds. The information required to be provided is designed to assist HUD and grantees assess performance in administering CDBG funded rehabilitation activities and, if necessary, make management improvements. Guidance used by HUD to analyze Form 4949.5 information establishes procedures to compute rehabilitation delivery costs and states that delivery costs exceeding twenty-five

Finding 2

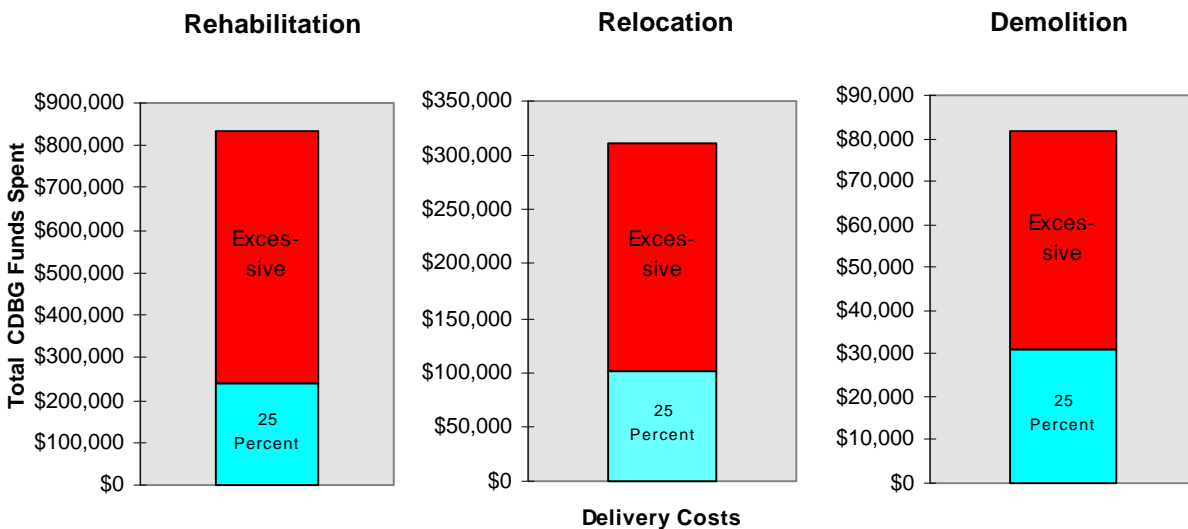
percent of the total CDBG obligations are exceedingly high and should be further evaluated for reasonableness and appropriateness. Although the HUD guidance applies this twenty-five percent benchmark to rehabilitation activities, we considered the benchmark a useful standard to measure delivery costs for other CDBG funded activities.

Delivery costs were excessive

During FY 1997 the NRHA expended about \$1.49 million in CDBG funds to provide direct rehabilitation, relocation, and demolition benefits to the community. Additionally, the NRHA used another \$1.23 million in program funds to pay related staff and overhead costs associated with delivering these activities. Details were:

ACTIVITY	DIRECT BENEFITS	DELIVERY COSTS	DELIVERY COST PERCENTAGE
Rehabilitation	\$959,996	\$835,301	87 %
Relocation	404,479	311,833	77 %
Demolition	124,807	81,495	65 %
TOTAL	\$1,489,282	\$1,228,629	82 %

The delivery costs were exceedingly high given HUD’s 25 percent acceptability benchmark, as illustrated for each activity below:



Excessive delivery cost charges for the CDBG funded rehabilitation, relocation, and demolition activity amounted to about \$595,302, \$210,713, and \$50,293, respectively, and totaled \$856,309.

Rehabilitation

During FY 1997, the NRHA expended \$959,996 in CDBG funds for 47 rehabilitation loans. The NRHA charged another \$835,301 in direct staff and overhead costs to deliver the rehabilitation program. We analyzed the delivery costs in accordance with HUD Handbook 6510.2 and HUD Form 4949.5 and determined the costs to be exceedingly high. For example, based on the reported staffing costs and CDBG funded obligations for all rehabilitation activities provided directly to the community, we determined the delivery cost percentage was about 87 percent, far exceeding HUD's 25 percent acceptability guideline.

Responsible personnel told us the rehabilitation program was highly complex, involved funding from several sources, and required significant staff and overhead resources to manage. We were also told that the CDBG funding was only a small portion of the funds used to further the NRHA's rehabilitation activities. NRHA officials believed that the delivery costs charged to the program were reasonable when evaluated against the total amount of funding used. While our review showed that the rehabilitation program involved several funding sources, HUD guidance requires activity delivery costs be evaluated relative to the amount of CDBG funds used to provide direct benefits. Notwithstanding this evaluation, we question the amount of delivery costs charged to the program because:

- Grant funds were used to pay the delivery costs associated with activities funded exclusively with non-CDBG resources. In addition to the \$959,996 to eligible beneficiaries during FY 1997, the NRHA used about \$2.1 million from other non-CDBG sources to include city, state, private, and other federal sources. Although the CDBG funds amounted to about 31 percent of the total amount of funding used in the rehabilitation program, the grant was used to finance nearly all of the delivery costs. Officials stated the other non-CDBG funding sources did not have provisions for

charging staff and overhead costs; accordingly, these delivery costs were charged to the CDBG program.

- Employee salaries may have been charged to the program for work that did not directly relate to the performance of CDBG funded activities. The \$835,301 in delivery costs charged to the CDBG rehabilitation program during FY 1997 included \$719,377 for payment of wages and fringe benefits for rehabilitation division personnel. Although CDBG funds accounted for only 31 percent of the funds used to complete rehabilitation initiatives, about 65 percent of the divisions total wages was charged as delivery costs.
- Other direct costs charged to the program appear questionable. Of the \$835,301 in rehabilitation delivery costs paid with CDBG funds, \$115,924 was used to pay an allocated portion of rent, travel, and vehicle costs (\$64,124) and architectural and engineering service expenses (\$51,800). Since similar costs were expensed in accordance with cost allocation plans and documentation was not available to show how these allocated costs were directly related to specific rehabilitation projects, classifying them as delivery costs do not appear to meet direct cost criteria. Additionally, responsible personnel indicated that the \$64,124 was charged to the program as an administrative cost; apparently duplicating the same amount charged as a rehabilitation activity delivery cost. Unless this amount is reconciled and appropriate documentation is provided that shows the payments were not duplicative, the \$64,124 should be paid back to the program.

In accordance with HUD and OMB guidance, the CDBG program should only fund those staff and overhead costs that are directly associated with the implementation of an eligible activity. As evidenced by the above examples, other costs may have been inappropriately included.

Relocation and demolition

During FY 1997, the NRHA used \$404,479 in CDBG funds to provide relocation benefits to 121 eligible participants. Similarly, CDBG funds totaling \$124,807 were used to finance the demolition of 23 structures. In addition to these direct community benefits, staff and overhead costs charged to the CDBG program to deliver the relocation and

demolition program amounted to \$311,833 and \$81,495, respectively. As previously illustrated, the delivery cost charges far exceeded reasonable limits. We analyzed the delivery costs for these activities and determined that they were excessive, in part, because a significant portion may have been inappropriately charged as direct costs. The program funded staff and overhead costs for personnel who worked in other divisions that did not appear to be directly involved with the implementation of CDBG funded relocation and demolition activity. The following chart summarizes our analyses:

Activity	Delivery Costs	Direct Activity Personnel Costs	Other Personnel Costs	Division Location of Other Personnel
Relocation	\$311,833	\$161,404	\$150,429	Development Operations, Rehabilitation Services, Renewal Services
Demolition	\$81,495	\$60,924	\$20,571	Development Operations, Rehabilitation Services

We performed a limited review of timekeeping and payroll allocation procedures and determined that sufficient documentation was not available to support employee time charges to CDBG activities. Time charges appeared to be based on pre-determined percentages and were not supported by an actual accounting of time spent on CDBG projects. Charging staff and overhead costs for personnel not directly involved with providing relocation and demolition services is not consistent with HUD and OMB guidance.

Summary

Although the Grantee and City officials have expressed concern over the amount of CDBG funds used to deliver eligible activities, a detailed analyses to ascertain their reasonableness and appropriateness has not been conducted. We recognize that multiple funding sources could contribute to the unusually high delivery costs. However, delivery costs also appear to be high because:

- CDBG funds were used to pay the delivery costs of activities funded exclusively by non-CDBG resources; and

- Indirect costs and personnel costs not directly associated with program delivery were inappropriately charged as delivery costs.

To ensure that CDBG funded activities are efficiently managed and direct community benefits are maximized, the Grantee should perform a detailed study of the NRHA's delivery cost determination procedures and ascertain if the unusually high delivery costs associated with the rehabilitation, relocation and demolition programs were an appropriate expenditure of scarce community development funds.

Auditee Comments

The Grantee stated that it was very cognizant of the need to ensure that maximum funding from all sources was directed towards the community. Over the past ten years, CDBG eligible projects totaling over \$63 million have been financed with local funding sources. During this period, the City has utilized more of its CDBG dollars to fund staffing support for implementing non-CDBG (although eligible) activities. In recognition of the issues raised in the finding, the City will modify its FY 1999 CDBG reporting to more fully describe all service delivery costs.

The NRHA commented that the \$115,924 reported in the finding as "other direct costs" for a portion of the rehabilitation delivery cost was overstated by \$64,000 because this amount was instead charged as part of the NRHA's administrative costs. The NRHA further stated that it is not fair or reasonable to only consider financial assistance provided with CDBG funds when calculating the delivery cost percentage. The NRHA was not aware of any HUD regulations that prohibits consideration of non-CDBG funding sources when evaluating program delivery efficiency. It believes that the actual cost to implement its residential rehabilitation program was fair and reasonable. Regarding the relocation and demolition delivery costs, the NRHA stated that they included in the delivery costs those persons responsible for implementing these activities amongst the twelve neighborhood project areas. The NRHA suggested they understood the concerns raised by the finding on this issue and is prepared to discuss the

possibility of using non-CDBG funds for payment of a portion of the program delivery costs.

OIG Evaluation of
Auditee Comments

\$115,924 was charged as delivery costs under “other direct costs” for rehabilitation activities and was correctly reported as such to HUD on form 4949.5. We cannot find any basis for the NRHA’s contention that these costs were overstated by \$64,000. As stated in the finding, the costs making up the \$115,924 were questionable since similar costs were already allocated based upon the NRHA’s administrative cost allocation plans. The NRHA’s comments suggest, therefore, that the \$64,124 in other direct costs discussed in the finding may have been charged to the CDBG program twice. Accordingly, appropriate documentation needs to be provided to support the allocation of the \$64,124 as non-duplicative or the program should be reimbursed for this amount. An appropriate recommendation was added to address this issue.

As stated in the finding, procedures require HUD personnel to evaluate CDBG program delivery efficiency by analyzing cost information provided by Grantees on HUD Form 4949.5. Guidance used by HUD to determine delivery cost percentages prescribes the use and analyses of specific cost data as reported on HUD Form 4949.5 and specifies the formulas to be used to compute delivery cost percentages. The guidance specifically requires that only CDBG funding be used to compute delivery cost percentages. Although non-CDBG funding source amounts are required to be reported, this information is specifically omitted from the delivery cost analyses and not used to compute cost percentages. While we acknowledged managing multiple funding sources could result in increased staff and overhead costs, our analyses and conclusions was performed in accordance with and based upon HUD guidance. Further, as expressed in the finding, exceedingly high delivery costs were due, in part, to the unsubstantiated charging of indirect expenses and personnel costs not directly associated with program delivery.

Recommendations

We recommend that the grantee:

- 2A. Provide adequate support for the \$64,124 in grant rehabilitation delivery costs to show that they were not duplicative of costs paid as part of grant administrative expenses or repay the costs to the CDBG program.

- 2b. Perform a detailed study of the subgrantee's delivery cost procedures to determine if the basis for charging staff and overhead costs to deliver rehabilitation, relocation, and demolition benefits to the community are reasonable and appropriate. At a minimum:
 - Ensure only those staff and overhead costs directly associated with the implementation of CDBG assisted activities are charged to the program.

 - Determine the feasibility of using other non-CDBG funding sources to finance staff and overhead costs for rehabilitation initiatives.

 - Review timekeeping practices and validate that employee compensation charged to the CDBG program is sufficiently documented to show the specific CDBG activity and the extent of time devoted to its performance.

The Norfolk Redevelopment Housing Authority Did Not Maintain Records According to Program Guidelines

Contrary to program guidelines, the Grantee's subrecipient, the Norfolk Redevelopment Housing Authority (NRHA) did not maintain adequate records for their property acquisition, rehabilitation and relocation activity. NRHA officials believed that their neighborhood conservation and redevelopment plans for acquisition and rehabilitation activity was sufficient to meet HUD record keeping requirements. However, the plans did not contain information that fully described each CDBG assisted activity and how each activity met assigned national objectives. Additionally, the NRHA applied last resort housing provisions to pay replacement housing and rental assistance payments in excess of authorized limits without properly documenting and justifying their use. As a result, the Grantee had minimal assurance that CDBG funded property acquisition and rehabilitation activities were consistent with program goals and that excess relocation payments totaling \$82,368 were justified and reasonable.

Criteria

24 CFR 570.506 (a) states that the grantee must maintain records that provide a full description of each CDBG assisted activity to include its location, the amount of CDBG funds budgeted, obligated and expended, and its eligibility provision. Further, 24 CFR 570.506 (b) requires that sufficient records be maintained that shows that each assisted activity meets one of the national objective criteria.

24 CFR 570.200(a)(2) states that grant recipients must certify that their projected use of funds has been developed so as to give maximum feasible priority to activities which will carry out one of the national objectives of: (i) benefit to low and moderate income families, (ii) aid in the prevention or elimination of slums and blight, or (iii) meeting a particularly urgent community development need.

24 CFR 570.506 (b) (5) states that for each activity determined to benefit low and moderate income persons based on the creation of jobs, documentation is required that shows employers have agreed in writing to make at least 51 percent of the jobs available to low and moderate income persons or that at least 51 percent of the full-time jobs will be held by low and moderate income persons. Further, the recipient and businesses are required to document the type of jobs to be created and what actions

will be taken to ensure eligible persons are given first consideration for those jobs.

For each activity determined to aid in the prevention or elimination of slum or blighted conditions on an area basis, 24 CFR 570.506 (b) (8) requires that records be maintained that show the boundaries of the area and a description of the conditions which qualified the area at the time of its designation in sufficient detail to demonstrate how the area met the slums and blight national objective criteria. Additionally, 24 CFR 570.506 (b) (9) states that for each residential rehabilitation activity determined to aid in the prevention or elimination of slums and blight in a slum or blighted area, records must (i) identify the local definition of sub-standard, (ii) contain a pre-rehabilitation inspection report that describes the deficiencies in each structure, and (iii) describe the details and scope of CDBG assisted rehabilitation for each structure.

24 CFR 570.606 establishes that persons displaced as a result of HUD assisted acquisition activity shall receive relocation assistance in accordance with 49 CFR part 24, the Uniform Relocation Assistance and Real Property Acquisition Policies Act.

49 CFR 24.401(b) prescribes that the replacement housing payment for eligible 180 day occupant may not exceed \$22,500. Further, 49 CFR 24.402(b) states that an eligible displaced person who rents a replacement dwelling is entitled to a rental assistance payment not to exceed \$5,250.

49 CFR 24.404(a) "Replacement Housing of Last Resort" states that "...whenever a program or project cannot proceed on a timely basis because comparable replacement dwellings are not available within the monetary limits for owners or tenants,... the Agency shall provide additional or alternative assistance..."

49 CFR 24.404(a)(1) requires an adequate case-by-case justification to support a decision to provide last resort housing assistance. The justification must show that appropriate consideration has been given to the availability of comparable replacement housing, available resources, and the individual circumstances of the displaced person. Last resort housing assistance can also be justified if it is

determined that a limited supply of replacement housing is available to displaced persons within an entire project area, the project cannot be completed in a timely manner, and the method for providing last resort housing assistance is cost effective.

Property Acquisition

During FY 1996 and 1997, the NRHA expended \$3.1 million to acquire 80 properties. Our review of 35 acquisition files and other relevant documentation, disclosed 34 of the 35 files maintained by the NRHA did not contain sufficient documentation to support its CDBG funded property acquisition activity and assigned national objectives as illustrated below:

NATIONAL OBJECTIVE	FILES	DESCRIPTION OF DEFICIENCY
Not in File	12	Files did not contain any documentation to show what national objective would be achieved.
Slum or Blight	11	Files did not contain any documentation showing what slum and blighted conditions prevailed or how the acquisition of the property met national objective criteria.
Low Mod Income Housing	8	Files did not contain any details concerning a full description of the activity or any references to a detailed conservation or redevelopment plan.
Creation of Jobs for Low Mod Income Persons	3	Files did not contain any of the required records to show that written agreements were made with prospective businesses to provide employment opportunities to low and moderate income persons.
Total	34	

Project managers responsible for initiating property acquisitions stated the conservation or redevelopment plan for each project area was used as the basis for the property purchases and contained the required details to support the national objective assigned to each acquisition. Review of the plans showed that they contained general information concerning project area boundaries, community history, existing conditions, rehabilitation standards, and overall plan objectives. However, they did not contain sufficient details

to show how national objectives relating to providing housing and jobs to low and moderate income persons or prevention or elimination of slum and blight conditions were applicable on a case-by-case basis.

Property Rehabilitation

During FY 1997, the NRHA expended approximately \$960,000 in CDBG funds to make 47 loans to rehabilitate 58 units. Review of 10 of the 47 rehabilitation loans disclosed the case files did not contain sufficient documentation to support the activity objectives as illustrated below:

- 7 of the 10 cases were to provide rehabilitation assistance to low and moderate income households. Although case files contained sufficient documentation to show that the beneficiaries met household low and moderate income eligibility requirements, documentation was not available to show why the property was deficient and what rehabilitation was needed. Rehabilitation Division personnel told us that the neighborhood conservation and redevelopment plans contained the specific details of each project area's rehabilitation program. Although our review of these plans showed that property rehabilitation standards had been established, rehabilitation case files did not contain any references to the standards or identify how the property's deficiencies were related to the standards.
- 3 of the 10 cases were designed to eliminate or prevent blight in a slum or blighted area. However, contrary to regulatory requirements, the case files did not identify the conditions which qualified the project as a slum and blighted area or provide a local definition of "sub-standard". Also, pre-rehabilitation inspection reports describing each structure's deficiencies were not prepared and the details and scope of each structure's CDBG assisted rehabilitation was not identified. Responsible Rehabilitation Division personnel stated inspection reports documenting required details were prepared at one time, but the practice was stopped due to staff shortages and efforts to reduce paperwork.

Relocation Assistance

As part of its CDBG funded relocation program, the NRHA made replacement housing and rental assistance payments that exceeded regulatory limits. During FY 1996 and 1997,

the NRHA processed 237 CDBG funded relocation cases that cost the program \$886,503. We performed a detailed review of 36 cases processed during this timeframe. Our selection included all cases (18) that appeared to exceed the housing or rental assistance limits and required appropriate justification. We reviewed relocation files and related documentation to determine if relocation payments were reasonable and adequately justified. Our review showed that excess payments totaling \$82,368 were made in the 18 relocation cases we identified as having exceeded prescribed regulatory limits. See Appendix D for details covering the eighteen cases.

Last resort housing assistance

According to Relocation Manager, payments in excess of limits were made because affordable comparable replacement housing was not available to the displaced persons. Accordingly, last resort housing provisions were used to make payments in excess of regulatory limits. However, our review of available documentation for these 18 cases showed that the required justification substantiating the use of last resort housing provisions was not contained in case files. In fact, relocation files did not contain any information that indicated suitable conditions existed to warrant payment of additional relocation assistance under last resort housing regulations. For example, one displaced person relocated to Georgia and was issued a replacement housing payment of \$41,600, \$19,100 over the maximum amount allowed. The case file did not contain any documentation indicating the circumstances that would justify assistance over the allowable limits.

Unless replacement housing and rental assistance payments exceeding regulatory limits are properly justified, there can be no assurance that the payments are necessary and reasonable. Accordingly, the \$82,368 in excess relocation payments identified during the audit are unsupported and need to be justified or paid back to the program.

Summary

The NRHA needs to maintain documentation that details its acquisition, rehabilitation and relocation activity according to HUD requirements. Acquisition and rehabilitation case files should contain sufficient information to clearly show how the use of CDBG funds will meet national objectives. The local definition of sub-standard needs to be established

and the area conditions dictating the need for slum and blight designation should be documented. Additionally, pre-rehabilitation inspection reports that document the relevant rehabilitation standards for each structure and fully describe noted deficiencies need to be prepared and maintained to ensure that only necessary improvements are made. Moreover, replacement housing and rental assistance payments exceeding regulatory limits need to be properly justified to ensure they are necessary and reasonable. Accordingly, the \$82,368 in excess relocation payments identified during the audit are unsupported and need to be justified or paid back to the program.

Auditee Comments

The Grantee, through its subrecipient, acknowledged that improvements were required in its recordkeeping process. Accordingly, the Grantee stated that procedures would be strengthened by making sure that:

- property acquisition files contain the necessary detail to fully describe the acquisition rationale, property location, and how the activity meets the assigned BNO.
- rehabilitation files properly describe a parcel's location within a defined conservation area, its existing deteriorated condition, and how rehabilitation of the site is needed in order to meet the standards in neighborhood conservation plans.
- when required, sufficient rationale is provided to support the appropriateness and use of last resort housing provisions to authorize relocation assistance in excess of statutory limits.
- relocation cases requiring the use of last resort housing provisions are audited and approved by the Relocation manager prior to payment authorization.
- recordkeeping performance measures are established in the FY 1999 subrecipient contract.
- City staff conduct on-site reviews of project files to ensure recordkeeping requirements (and other performance areas) are satisfactorily met.

Regarding the excess replacement housing and rental assistance payments, justification was submitted for the 18 cases cited in the finding .

OIG Evaluation of Auditee Comments

The Grantee's acknowledgment of recordkeeping deficiencies and prompt action to make corrections is commendable. Implementation of the stated procedural changes should ensure that records are properly maintained to meet HUD requirements.

Our review of the justifications submitted for the 18 relocation cases exceeding authorized assistance limits showed that additional information is required. As stated in the finding, 49 CFR 24.404(a)(1), prescribes that the use of last resort housing provisions to authorize relocation payments in excess of statutory limits requires appropriate consideration be given to the availability of comparable replacement housing, available resources, and the individual circumstances of the displaced person. Further, last resort housing assistance can also be justified if it is determined that a limited supply of replacement housing is available to displaced persons within an entire project area, the project cannot be completed in a timely manner, and the method for providing last resort housing assistance is cost effective. Although the justifications generally indicated sufficient consideration was given to the availability of comparable housing, they did not always adequately address location considerations, project completion timeliness, or explain the cost effectiveness of providing the increased benefits.

Recommendations

We recommend that the grantee require the NRHA to:

- 3A. Develop a full and detailed description of its CDBG funded acquisition activities and maintain the description in applicable program files.
- 3B. Ensure that each property acquisition case file contains sufficient documentation to fully support the basis for the purchase and that the relevant criteria applicable to low and moderate income

housing and job creation and slums and blight national objectives are adequately documented.

- 3C. Ensure that each rehabilitation case file contains adequate documentation to support the basis for assigning low and moderate income and slums and blight national objectives. At a minimum ensure that:
- for activities designed to meet slum and blighted area objectives, a local definition of sub-standard is developed and the conditions which qualified the project as a slum and blighted area are documented.
 - pre-rehabilitation inspection reports documenting the prevailing deficiencies and the applicable housing standards are prepared and maintained.
 - the details and scope of the CDBG assistance is properly documented.
- 3D. Provide justification to support the payment of replacement housing and rental assistance in excess of amounts allowed by law or repay the program \$82,368 from non-Federal sources.
- 3E. Require the NRHA to establish procedures to ensure that the use of last resort housing provisions to substantiate relocation payments in excess of regulatory limits are properly justified and documented in case files.

The Grantee Did Not Effectively Monitor Subgrantee Performance

The grantee did not adequately monitor its subrecipient, the Norfolk Redevelopment Housing Authority (NRHA). Although a formal monitoring plan had been established, procedures were outdated and the grantee had not conducted a formal review of subrecipient operations since 1992. Monitoring had not been accomplished because the grantee placed a low priority on formal monitoring activity and instead relied on informal, day-to-day management to evaluate subrecipient performance. As a result, HUD and the grantee had minimal assurance that the subrecipient properly implemented HUD assisted programs and met intended program goals.

24 CFR 85.40 (a) states that Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved.

24 CFR 570.501 (b) provides that the Grantee is responsible for determining the adequacy of performance under subrecipient agreements and for taking appropriate action when performance problems arise.

Background

Since 1975, the NRHA has been the grantee's prime subrecipient and has been contracted with to carry out the bulk of the grantee's CDBG activities. Of the \$15 million in CDBG funds available to the grantee during FY 1997 and 1998, \$12.1 million (81 percent) was allocated for use by the NRHA to carry out the grantee's conservation and redevelopment initiatives. The grantee's Finance Department, Bureau of Budget was responsible for developing and implementing procedures for monitoring subrecipient activities.

Procedures need to be updated and formally implemented

Although the grantee had developed monitoring guidelines, procedures were outdated and had not been formally implemented.

- The grantees's current monitoring plan was dated February 1991. The plan described the nature of its HUD assisted programs and subrecipient relationships in effect at the time the procedures were drafted. Over the years, the programs and relationships have changed; however, the monitoring plan was not updated to reflect the current status of the grantee's CDBG programs. For example, the plan identified the NRHA as the primary subrecipient and three secondary subrecipients. Contrary to the plan, during FY 1997 and 1998, the grantee had only one subrecipient, the NRHA.
- The grantee has not conducted a formal monitoring review of subrecipient activities since 1992. While available documentation supports that a 1992 review was performed and some concerns were noted, review results did not appear to be used as a basis for improving subrecipient operations. A formal report was never issued nor was there any effort to communicate and follow-up on the identified problem areas.

Responsible personnel told us that other higher priority requirements and personnel shortages precluded updating the monitoring procedures and conducting timely reviews of subrecipient performance. Although formal reviews were not conducted, personnel told us that informal contact with its subrecipient through meetings, correspondence, and day-to-day management provided sufficient information for the grantee to assess implementation of its CDBG programs. While we agree that informal management constitutes an important component of maintaining oversight, it should not be used as a replacement for an in-depth review of subrecipient activities.

Monitoring overall program objectives and results

The Grantee needs to evaluate the subrecipient's overall community development initiatives to ensure that CDBG resources are managed efficiently and program objectives are met in the most cost-effective manner. Items of particular concern noted during the audit were:

1. Property was acquired and held for significant time periods before disposition and development. An analyses of the city's FY 1997 GPR showed that the NRHA had acquired 41 parcels costing over \$1.1

million that were purchased during or before 1993 that had not been redeveloped or disposed of as of June 1997¹, illustrated as follows:

Number of Years Parcel Held	Number of Parcels	Acquisition Costs
3 to 4	15	\$531,181
5 to 6	23	\$407,770
7 and Over	3	\$167,100
TOTAL	41	\$1,106,051

In one case, a Park Place neighborhood parcel was acquired in 1993 for \$90,000. As of September 1998, the parcel had not been sold or redeveloped and was still held in inventory. It should be noted that 29 of the 41 parcels costing over \$750,000 were acquired under low and moderate income housing objectives. Prudent management would dictate more timely redevelopment under these circumstances in order to satisfy stated national objectives. We did not quantify the amount of ancillary CDBG expenditures associated with these 41 acquisitions; however, demolition, relocation, and retention costs were certainly significant. Accordingly, the total CDBG investment in these parcels was well in excess of the \$1.1 million initially paid to acquire the properties. For a more detailed description of the properties held, see Appendices B and C.

As discussed in finding 3, acquisition files did not contain sufficient documentation to support the nature of the NRHA's acquisition activity, a full description of the intended end use, and the basis for assigned national objectives. Accordingly, we could not determine why property was acquired, improved, and maintained for time periods exceeding 3 years; nor could we ascertain what community development objectives were achieved for the expenditure and exceedingly lengthy holding period for disposition and development. The Grantee needs to closely monitor the subrecipient's CDBG funded acquisition

¹ We attempted to verify the status of each parcel through visual inspections. Observation results showed that 7 of the 41 parcels appeared to have been redeveloped with rehabilitated or newly constructed structures.

activity to ensure that resources are efficiently managed and that objectives are achieved in a timely manner.

2. Redevelopment costs appear high. As noted in findings 1, 2 and 3, national objectives were not achieved, excessive relocation assistance was not properly justified, and staff and overhead costs related to rehabilitation, relocation, and demolition initiatives appeared excessive. Total CDBG expenditures not meeting stated objectives and exceeding acceptable levels amounted to over \$1.7 million. OMB Circular A-87 dictates that Grantees of federally-assisted programs are responsible for the efficient and effective administration of grant programs through the application of sound management practices and the adoption of appropriate cost allocation principles. To ensure that CDBG initiatives meet intended objectives, bear only its fair share of allocable costs, and are managed efficiently and effectively, the Grantee needs to include in its monitoring plan detailed procedures to continually scrutinize subrecipient performance and costing procedures.

Summary

In light of the problems presented in this report, the grantee needs to place more emphasis on its monitoring responsibility and update its monitoring procedures to include the current status of its CDBG programs and to ensure that the problems identified during the audit are incorporated into the plan. Additionally, the grantee needs to take prompt action to implement monitoring procedures and conduct formal reviews of subrecipient performance, communicate review results, and follow-up on problem resolution. Because the grantee had not implemented an effective monitoring system, HUD and the grantee had little assurance that funds were being used in an economical and effective manner, or that program objectives were met. Had the grantee implemented an effective monitoring program, the issues discussed in findings 1 through 3 could have been detected and corrective actions initiated to preclude the development of significant problems.

Auditee Comments

The Grantee stated that it developed a monitoring agenda in September 1997 in response to a HUD Field Office finding but did not implement the plan. The Grantee acknowledged the issues raised by the OIG and plans to update and proceed with its monitoring agenda. The agenda identified key monitoring objectives, the frequency of reviews, responsible monitoring staff, and established a quarterly reporting and follow-up requirement. The City has already focused on previously issued draft OIG findings and has worked with the NRHA to implement expanded recordkeeping procedures. Additionally, during June and July 1998, City staff conducted on-site reviews to follow-up on the issues raised in finding 1.

The Grantee has also amended its contract with the NRHA to include specific requirements for performance measures to allow the City to evaluate program objectives and results. Some of the included requirements are a five-year disposition plan to reduce the inventory of vacant CDBG related parcels and application of expanded recordkeeping procedures for all prior property acquisition and rehabilitation files. The amended contract will also require the implementation of an automated system that will link the necessary financial and program data for maintenance of current management reporting information including a comprehensive activity-based costing system.

OIG Evaluation of Auditee Comments

The Grantee's ongoing and planned actions should greatly improve subrecipient monitoring. As stated in the finding, the Grantee should continue to place sufficient emphasis on its monitoring responsibility to ensure full, long-term implementation of its monitoring agenda.

Recommendations

We recommend that the grantee:

- 4A. Update their subrecipient monitoring plan to reflect current conditions. Ensure that the problem areas identified during the audit are included in the plan.
- 4B. Implement monitoring procedures and conduct periodic formal monitoring of subrecipient activities. Ensure that the monitoring results are properly

documented and a follow-up system is established to make sure identified problems are resolved in a timely manner.

- 4C. Ensure monitoring procedures include detailed provisions to verify the efficiency and effectiveness of the subrecipient's community development initiatives to make sure CDBG resources are maximized and objectives achieved in the most cost-effective manner.

Management Controls

In planning and performing our audit, we considered the internal controls of the management of the City of Norfolk and the NRHA in order to determine our auditing procedures and not to provide assurance on internal controls. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

Relevant Internal Controls

We determined that the following internal control categories were relevant to our objectives:

- Administrative controls over property acquisition, rehabilitation, relocation, and other miscellaneous activities.
- Accounting for and maintaining control over program delivery costs.
- Maintaining proper records.
- Administrative controls over subgrantees.
- Program income.

We assessed these controls. To the extent possible, we obtained an understanding of the City's and NRHA's procedures and HUD requirements, assessed control risk, and performed various substantive tests of the controls.

A significant weakness exists if internal control does not give reasonable assurance that goals and objectives are met; 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. Based on our review, significant weaknesses existed in the internal controls we tested as discussed in the findings.

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Follow Up On Prior Audits

An Office of Inspector General audit related memorandum (report number 92-PH-241-1804, dated September 14, 1992) of the City's Community Development Grant Program contained one finding. The finding disclosed that the NRHA incorrectly awarded a repayment grant. In one case, an applicant received a \$10,000 repayment grant for which he was not eligible. The finding was resolved.

Schedule Of Questioned Costs

<u>Finding Number</u>	<u>Type of Questioned Costs</u>	
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>
1	\$675,831	\$90,226
2		\$64,124
3		\$82,368

1/ Ineligible amounts are clearly not allowed by law, contract, or HUD policies or regulations.

2/ Unsupported amounts are not clearly eligible or ineligible, but warrant being contested for various reasons, such as the lack of satisfactory documentation to support eligibility.

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Property Acquired Before Or During 1993 And Currently Pending Disposal/Redevelopment

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Selected Photographs Of Undeveloped Properties Acquired Before 1993 Under Low And Moderate Income Housing National Objectives

(To Date Subgrantee Has Not Initiated Redevelopment)



3615 Granby Street Acquired: 9-30-92 Cost: \$65,000



239 W. 34th Street Acquired: 8-13-93 Cost: \$16,000

(To Date Subgrantee Has Not Initiated Redevelopment)



2605 Church Street Acquired: 10-11-91 Cost: \$15,000



319 W. 33rd Street Acquired: 11-14-90 Cost: \$22,500

(To Date Subgrantee Has Not Initiated Redevelopment)



300 W. 26th Street Acquired: 5-1-92 Cost: \$22,000



220-226 E. 26th Street Acquired: 10-21-91 Cost: \$53,500

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Schedule Of Excessive Relocation And Rental Assistance Payments

CASE	FY	REPLACEMENT HOUSING PAYMENT (\$22,500 LIMIT)	RENTAL ASSISTANCE PAYMENT (\$5,250 LIMIT)	AMOUNT EXCEEDING LIMIT
1	1997	\$41,600	-	\$19,100
2	1996	36,024	-	13,524
3	1996	28,528	-	6,028
4	1997	28,377	-	5,877
5	1996	28,253	-	5,753
6	1996	28,221	-	5,721
7	1996	25,230	-	2,730
8	1996	24,781	-	2,281
9	1997	24,128	-	1,628
10	1997	23,760	-	1,260
11	1997	23,653	-	1,153
12	1997	22,527	-	27
13	1997	-	10,569	5,319
14	1996	-	9,723	4,473
15	1996	-	8,966	3,716
16	1996	-	7,060	1,810
17	1997	-	7,008	1,758
18	1997	-	5,460	210
TOTAL				\$82,368

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Auditee Comments

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