



Issue Date	October 17, 1995
Audit Case Number	96-CH-241-1002

TO: John E. Riordan, Director, Community Planning and Development, Ohio State Office

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

SUBJECT: City of East Cleveland
Community Development Block Grant Program
East Cleveland, Ohio

We completed a review of the City of East Cleveland's Community Development Block Grant Program. The objectives of the review were to determine whether the City: (1) complied with Federal laws, HUD regulations, and other requirements; (2) had adequate controls to comply with these requirements; and (3) carried out its activities in an economical, efficient, and effective manner. HUD's Ohio State Office requested the audit.

The City has a new administration to operate the Program. The Director of the Community Development Department revised some policies and procedures for administering the Block Grant Program, and the Director of Finance was strengthening controls over the City's Finance Department. The City also engaged a nonprofit housing corporation to correct the problems in the City's residential rehabilitation program. Still, the City had work to do to bring its Block Grant Program into compliance with Federal laws, regulations and other requirements and carry out its activities in an economical, efficient and effective manner.

The City of East Cleveland did not: (1) achieve its primary objective of correcting code violations; (2) spend \$42,657 Block Grant money on eligible or supported activities; and (3) establish an effective system of internal controls.

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

If your staff has questions, please contact me at (312) 353-7832.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Executive Summary

We completed a review of the City of East Cleveland's Community Development Block Grant Program. The objectives of the review were to determine whether the City: (1) complied with Federal laws, HUD regulations, and other requirements; (2) had adequate controls to comply with these requirements; and (3) carried out its activities in an economical, efficient, and effective manner. HUD's Ohio State Office requested the audit.

The City has a new administration to operate the program. The Director of the Community Development Department revised some policies and procedures for administering the Block Grant Program, and the Director of Finance was working to improve controls over the Finance Department. The City also engaged a nonprofit housing corporation to correct the problems in the City's residential rehabilitation program. Still, as the findings show, the City had work to do to bring its Block Grant Program into compliance with Federal laws, regulations, and other requirements and carry out its activities in an economical, efficient and effective manner.

Housing rehabilitation did not meet its primary objective

The East Cleveland housing rehabilitation program, funded by the Community Development Block Grant Program, did not achieve its primary objective of correcting violations of the City's occupancy code. The program was deficient in all phases. Contract work specifications omitted corrective work for some violations. Then the City did not inspect rehabilitated homes for substandard work before it paid contractors. The City also included duplicate work in its specifications, and did not obtain the lowest prices. Because of the deficiencies, the City paid \$55,551 for substandard and duplicate work. Homeowners benefitted from the program, but they were, to varying degrees, adversely effected.

Administratively, the City did not use its waiting list correctly, did not obtain required liens on properties and promissory notes, and did not document the benefit to low or moderate-income families.

In 1994, the City suspended the rehabilitation program because of its problems and engaged a local housing organization to correct substandard work. The City intended to reassume administering the program. Based on our review, however, we concluded that without substantial improvement, the City will not have the capacity to operate a housing rehabilitation program effectively and economically.

Block Grant Program
paid for ineligible and
unsupported costs

The City of East Cleveland paid \$42,657 of Community Development Block Grant money for ineligible and unsupported costs. The ineligible costs consisted of \$16,765 for indirect costs the City should have charged to other programs, and \$18,887 for non-Block Grant activities. The City also did not have invoices to document \$7,005 worth of payments. The Director of Community Development said the previous Director during 1993 and 1994 did not follow policies and procedures. More critically, the City had not set up procedures to ensure proper payments. As a result, less money was available to pursue Block Grant Program objectives. On the positive side, the City improved its payment procedures during 1995.

Internal controls were not
effective

The City of East Cleveland did not have an effective internal control system. The City's Community Development Department did not: monitor subrecipients and other city departments, properly allocate salaries among city departments, obtain audits timely, segregate employees' duties at the City's Finance Department, and control keys to the check signing machines. The environment within the department was compromised because the City's existing controls were defective. As a result, the City did not ensure HUD that Block Grant money was safeguarded from misuse, loss, and waste.

Recommendations

We recommend that the City substantially improve its handling of the rehabilitation program or continue to use an outside agency to administer the program. We also recommend that the City: repay the Block Grant Program \$55,551 for incomplete, defective, and duplicate rehabilitation work; repay \$35,652 for ineligible expenditures and \$7,005 for unsupported expenditures; strengthen its internal controls; and correct items cited during our inspections of rehabilitated homes. We included specific recommendations in each finding.

We presented our findings to the Community Development Director during the audit. We held an exit conference on September 12, 1995. The City provided written comments to our findings and recommendations. We considered the responses in preparing our final report. We included

excerpts from the responses in each finding and in their entirety in Appendix B.

Table of Contents

Management Memorandum i

Executive Summary iii

Introduction 1

Findings

1 The East Cleveland Housing Rehabilitation Program Did Not Achieve Its Primary Objective of Correcting Code Violations 3

2 The City Paid for Ineligible and Unsupported Costs 21

3 The City of East Cleveland Lacked Effective Internal Controls 29

Internal Controls 39

Follow Up On Prior Audits 41

Appendices

A	Schedule of Questioned Costs	43
B	Auditee Comments	45
C	Distribution	57

(THIS PAGE LEFT BLANK INTENTIONALLY)

Introduction

The Community Development Block Grant Program was established under Title I of the Housing and Community Development Act of 1974. The Program provides grants to aid in the development of viable urban communities. The Program's purpose is to provide decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. The Act also addresses the conservation of the Nation's scarce energy resources, improvement of energy efficiency, and the provision of alternative and renewable energy sources. The City of East Cleveland received grants from HUD to achieve its goals of meeting one of three program objectives:

- Benefit low and moderate income persons
- Aid in preventing or eliminating slums or blight
- Address a need with a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

East Cleveland is incorporated, operates under its own Charter, and became an entitlement city in 1988. The Charter provides for the Mayor-Council form of government and authorizes the following services: Public Safety, Public Service, Water and Sanitation, Health and Social Services, Culture-Recreation, Public Improvements, and General Administrative Service.

HUD authorized the City of East Cleveland \$4,842,000 in Community Development Block Grant grants over the past four years. It has spent \$2,933,000 of the grants as the following table shows.

YEAR	AMOUNT AUTHORIZED	AMOUNT EXPENDED
1992	\$ 972,000	\$ 972,000
1993	1,184,000	1,184,000
1994	1,301,000	777,000
1995	<u>1,385,000</u>	<u>0</u>
	<u>\$4,842,000</u>	<u>\$2,933,000</u>

The City's Community Development Department administered the Program. Mrs. Venezuela Robinson, Director of Community Development, was the City's official representative for the Program. The Director of Finance was Gayle Smith. The records and books of account were at 13601 Euclid Avenue and 14340 Euclid Avenue, East Cleveland, Ohio.

Audit Objectives

The objectives of our review were to determine whether the City: (1) complied with Federal laws, HUD regulations, and

other requirements; (2) had adequate controls to comply with these requirements; and (3) carried out its activities in an economical, efficient, and effective manner. Our specific objectives were to determine whether:

- The City's rehabilitation program met its objective of correcting occupancy code violations and whether the City administered the program in an efficient and economical manner.
- The City spent Block Grant money for eligible and supported costs.
- The City had effective controls to ensure compliance with Federal laws, regulations, and other requirements and to ensure it spent Block Grant money economically and efficiently.

Scope and Methodology

We conducted the review at HUD's Ohio State Office and the City of East Cleveland. To find out HUD's concerns and obtain background information, we reviewed HUD monitoring and correspondence files. We also interviewed key persons at the Ohio State Office.

To evaluate the City of East Cleveland's Block Grant Program, we reviewed property files and work specifications, program policies and procedures, and the 1992 independent audit report. We interviewed City staff to obtain information about program administration and requirements.

An Office of Inspector General Construction Specialist reviewed work specifications and inspected 27 homes to find out whether code violations were corrected. We relied on the judgement of the Construction Specialist and interviews with homeowners to find out what code violations existed at the time of the City's initial inspection.

Our audit covered the period from January 1993 through February 1995. We extended the audit period as necessary. We did the field work between March and August 1995. We conducted the audit following generally accepted government auditing standards. We provided a copy of this report to the City's Community Development Director.

The East Cleveland Housing Rehabilitation Program Did Not Achieve Its Primary Objective of Correcting Code Violations

The East Cleveland housing rehabilitation program, funded by the Community Development Block Grant Program, did not achieve its primary objective of correcting violations of the City's occupancy code. The program was deficient in all phases. Contract work specifications omitted corrective work for some violations. The City did not inspect rehabilitated homes for substandard work before it paid contractors. The City also included duplicate work in its specifications, and did not obtain the lowest prices. Administratively, the City did not use its waiting list correctly, did not obtain required liens on properties and promissory notes, and did not document the benefit to low or moderate-income families.

The City's rehabilitation staff was not well versed in the City's occupancy code and the program requirements, and especially the electrical and plumbing requirements. An unapproved volunteer inspected some rehabilitation work. City staff that did inspections said they did not know that the City's code required compliance with the Building Officials and Code Administration National Property Maintenance Plan and Rule Number 6 of the National Electric Code dated 1987. One employee said the former Director told him not to correct certain code violations, analyze contractor prices, and approve any change orders. The administrative deficiencies were largely because of a lack of controls and oversight.

Because of the above problems, the City paid \$55,551 for substandard and duplicate work from rehabilitation costs totaling \$269,417 for the 27 homes we inspected. Homeowners benefitted from the program, but they were, to varying degrees, adversely affected. Specifically, homeowners signed promissory notes for the total costs of the rehabilitation that included incomplete and defective work. The promissory notes committed homeowners to live in substandard homes for eight to ten years. Otherwise, they had to pay for the rehabilitation cost or face losing their homes. Because of the administrative weaknesses, the City did not select applicants equitably, could not enforce occupancy requirements, and could not be sure that participants met income requirements.

In 1994, the City suspended the rehabilitation program because of its problems and engaged a local housing organization to correct substandard work. The City intended to reassume administering the program. Based on our review, however, we concluded that without substantial improvement, the City will not have the capacity to operate a housing rehabilitation program effectively and economically.

HUD Requirements

HUD Regulation 24 CFR 570.202(a)(1), permits spending Block Grant funds to finance the rehabilitation of homes. HUD Regulation 24 CFR 85.22(b) states that costs will be allowed according to cost principles applicable to the organization incurring the costs. Local governments must use the cost principles in Office of Management and Budget Circular A-87, Cost Principles for State and Local Governments. Paragraph (C)(1)(a) of Circular A-87 states that to be allowable, costs must be necessary and reasonable for proper and efficient administration of the program.

Program Objectives and Description

The City's policies and procedures stated that the objective of the rehabilitation program was to correct code violations. The City Codified Ordinances, Chapter 1351, established basic standards for residential occupancy. The City also incorporated into its occupancy code the Building Officials and Code Administration National Property Maintenance Plan and Rule Number 6 of the National Electric Code dated 1987.

The City operated two similar rehabilitation programs: the Code Enforcement Grant Program and the Deferred Loan Program. The programs were intended to rectify code violations that seriously affected the use and livability of a property. Rehabilitation costs were limited to \$15,000 for a single-family home. A lien was placed on the property for the rehabilitation costs. Homeowners had to repay the grants in full if they sold or transferred the property within eight to ten years. If the homeowner resided in the property for the required time, the City removed the lien, and the loan was forgiven.

City and Contractor Responsibilities

The City's policies and procedures stated that the City was responsible for preparing work specifications to correct code violations. The City was also responsible for inspecting the rehabilitation work while in progress and at completion.

The rehabilitation contracts were between the contractors and homeowners. Contractors were required to complete the work specifications incorporated in the contracts. The contracts also required the contractor to do all work to

meet local codes and property rehabilitation standards whether covered by the specifications.

The contracts prohibited changes to the contract specifications unless a homeowner had already corrected the violations. In these cases, the work items were to be deleted and the prices adjusted accordingly. The homeowner was to pay for any additional work outside the contract.

How we selected and inspected homes

We inspected 27 homes. The City had not rehabilitated any homes in 1994 and 1995. So, we judgmentally selected for inspection 29 of the 32 homes rehabilitated in 1992 and 1993. The homes selected were the most costly of the rehabilitated homes. We selected a large sample because of indicated problems with the City's rehabilitation program. We did not inspect two homes because their ownership had changed.

We inspected the homes to find out whether: the contractors corrected all code violations, specifications covered all code violations, and work was done completely and correctly. An Office of Inspector General Construction Specialist, accompanied by a City Rehabilitation Specialist, inspected the homes. We relied on our Construction Specialist's judgment and interviews with homeowners to find out whether code violations omitted from the specifications existed at the time of the City's initial inspection.

The City did not ensure the reasonableness of prices

The City did not independently estimate cost and analyze contractor prices to ensure the reasonableness of prices. HUD does not require independent cost estimates for homeowner-contractor contracts. However, they are an effective tool for analyzing the reasonableness of prices.

The City accepted the lowest-priced contract proposal without analyzing the price of individual work items. As a result, the City paid obviously unreasonable prices for some work items. For example, the City paid \$100 for a splash block under an outside downspout. At another property, the City paid \$275 to replace a light switch. A HUD Ohio State Office Rehabilitation Specialist told us that he would have allowed no more than a total of \$50 for a splash block and \$75 for a light switch, including labor.

Why cost estimates were not made

We received unreconcilable reasons on why cost estimates were not developed. The City Specialist said the former Director verbally instructed him not to prepare cost

estimates. The former Director told us, however, that he never told the City Specialist to stop them. The Specialist, he said, was not capable of estimating the costs.

Code violations were not corrected

Code violations existed in each of the 27 homes we inspected. In all, the 27 homes contained 447 uncorrected code violations. The City's work specifications did not require correction of 188 code violations. The specifications for 14 properties contained 25 duplicate work items.

The total rehabilitation costs of the 27 homes were \$269,417, of which \$55,551 was for substandard and duplicate work. The City paid \$39,578 for incomplete work, \$10,184 for defective work, and \$5,789 for duplicate work. The following table shows the inspection results in more detail.

Description	Number of Violations			
	Omitted	Incomplete	Defective	Totals
Code-Related				
Exterior maintenance	33	114	14	161
Electrical systems	46	42	7	95
Interior maintenance	23	37	6	66
General maintenance	29	2		31
Plumbing	8	12	1	21
Roofs/gutters	5	12	3	20
Handrails	15	5	1	21
Ventilation	19			19
Seven other code items	10	2	1	13
Subtotals	188	226	33	447
Non-code work		23	1	24
Totals	188	249	34	471

As the table shows, the uncorrected violations mostly related to exterior maintenance, electrical systems, and interior maintenance.

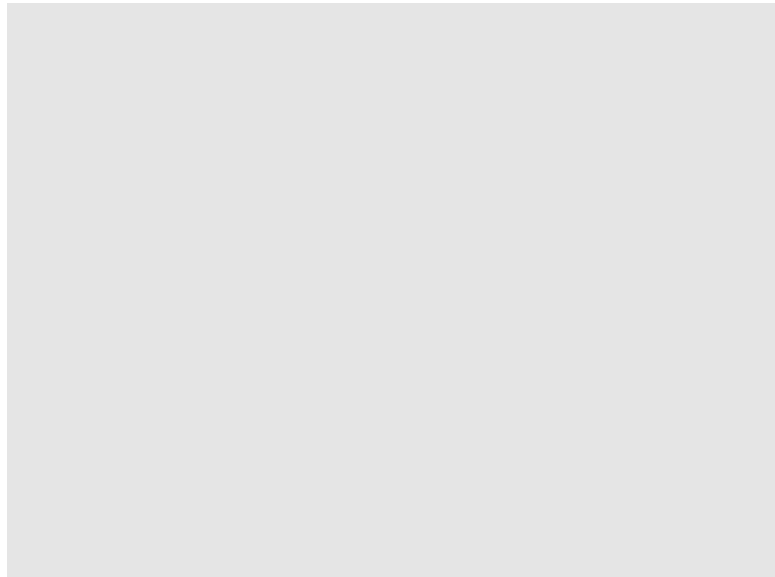
The specifications omitted some code violations and included duplications

Work specifications omitted correction of code violations but included duplicate work. The 188 omissions ran the gamut, covering 15 sections of City code. The most frequent omission, 46 items in total, related to correction of electrical systems violations. The next highest numbers of omissions were for exterior maintenance (33), general maintenance (29), and interior maintenance (23).

The specifications also included 25 duplicate work items. Duplicate work items were items listed twice on the specifications. Thus, the City paid the contractors twice for doing the same work once.

The following pictures show examples of code violations not cited by the City. We relied on our Construction Specialist's judgment and interviewed homeowners to find out whether code violations omitted from the specifications existed at the time of the City's initial inspection.

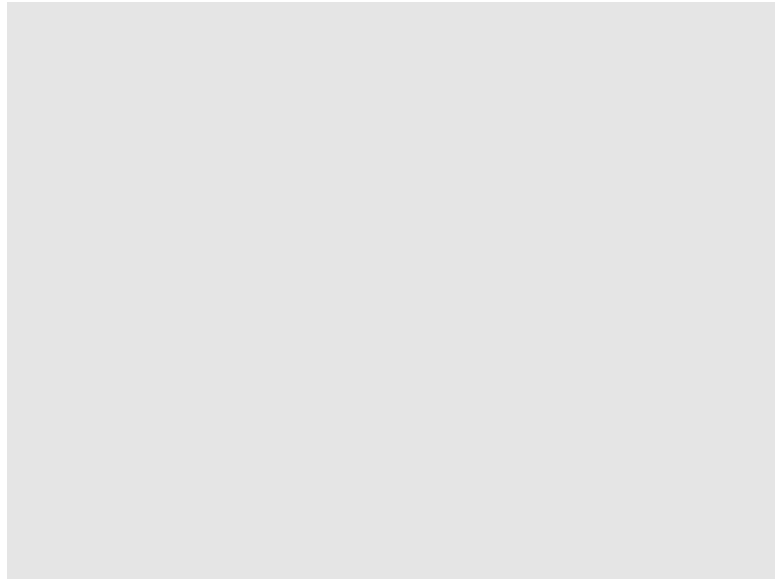
Contrary to the City code, water pipe cutoff valves were not required to be installed. The occupants risked flooding if the pipes had leaked. Also holes around the drain pipes were not sealed. Rodents and insects could have entered the residence through the holes.



1621-23 Delmont

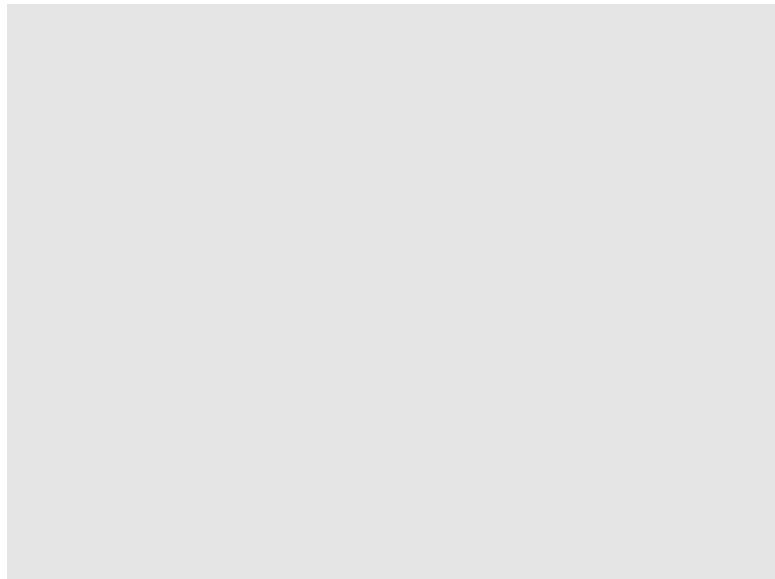
(THIS PAGE LEFT BLANK INTENTIONALLY)

The rear porch deck was rotted out. The City did not require replacement. People ran the risk of falling through.



14609-11 Orinoco

Dilapidated detached garage in the rear yard should have been required to be removed from the premises. The structure was a safety risk to the residents. It could have collapsed and injured anyone nearby.



1907 Rosemont

Why the specifications did not require correction of code violations

The City staff variously responsible for initially inspecting homes, preparing specifications, and inspecting contractor work told us that they were not knowledgeable about City code requirements. The City Specialist responsible for all the functions said he was not knowledgeable enough to identify all electrical and plumbing violations. The former

Director, however, told us that the City Specialist had received training.

Two Housing Department inspectors also made some initial inspections. The two inspectors told us that they did not know that contractors were required to comply with the City and industry codes, the Building Officials and National Code Administration of National Property Maintenance Plan, and Rule Number 6 of the National Electric Code. They believed that only compliance with the City residential occupancy code was required. They did not know that the City Codified Ordinances required compliance with all three codes. Based on the City Specialist's and Housing Inspectors' statements, we believe the City's staff were not knowledgeable enough to complete the initial inspections and write effective specifications.

Also, the City Specialist told us that the former Director instructed him to hold costs to a minimum. Therefore, he was not to correct code violations for driveways, sidewalks, and exterior paint. He also said the former Director told him not to approve change orders, regardless of City code requirements.

The Specialist's statement was not reasonable. The specifications omitted code violations other than driveways, sidewalks, and exterior paint. For example, the specifications omitted work to correct electrical, plumbing, ventilation, and interior maintenance violations. In addition, the City had approved change orders for some properties.

Why work items were duplicated

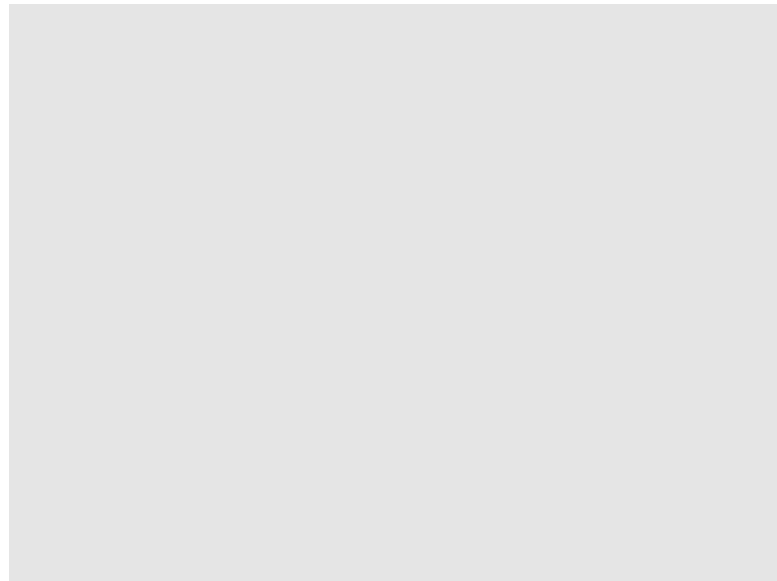
The City Specialist told us that an office worker typed the work specifications. The City Specialist could not remember whether he had proofread the specifications. This could explain the inclusion of duplicate items.

The City paid for incomplete and defective work

The City paid \$49,762 for substandard work: \$39,578 for incomplete work and \$10,184 for defective work. For the 27 homes we inspected, 226 work items to correct City code violations, and 23 non-code related work items were incomplete.

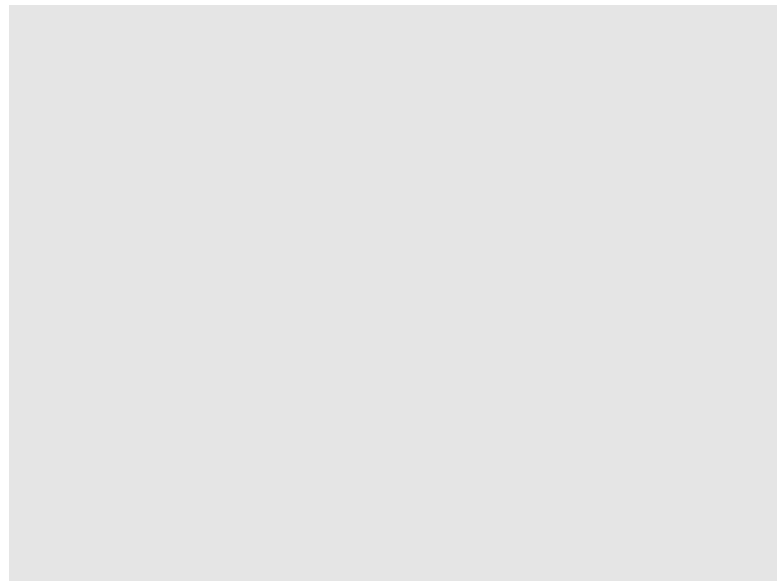
The following pictures show examples of incomplete work.

Contrary to the specifications, no repairs were made to the window. The owner had to use a prop to keep the window open. Occupants risked hand injury if the prop slipped.



1233 Melbourne

Broken and missing shingles were not replaced as required. Water will eventually leak through and cause interior damage and be a hazard to the occupants.

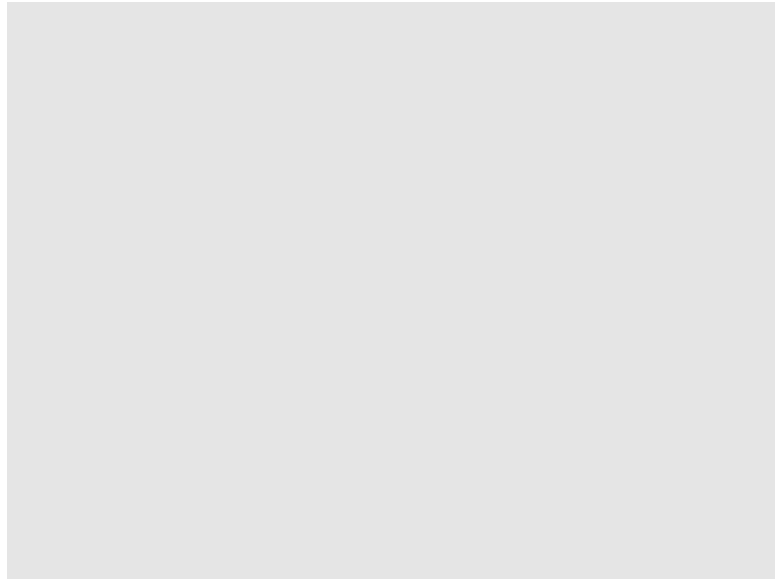


1096-98 Eddy

Besides the incomplete work, we detected 34 defective work items in 14 of the 27 homes inspected. The following picture is an example of defective work.

(THIS PAGE LEFT BLANK INTENTIONALLY)

The living room wall switches were required to be replaced. Only two were replaced. Electrical wiring was exposed in the third opening. Children could have stuck an object through the outlet and received a shock or been electrocuted.



14419 Alder

Why the City paid for incomplete and defective work

Based on the results of our inspections, review of the City's inspection reports, and discussions with the City's staff, we concluded that the City did not effectively inspect the rehabilitation work while in progress or upon completion. The City's procedures required the Specialist to inspect the properties at 30 percent completion, 80 percent completion, and 100 percent completion. The City was to pay contractors only for work items completed. The homeowner was to sign a certificate of completion and acceptance before final payment to the contractors.

Interim inspection reports did not show the percentage of completion. Without determining the percentage of completion, the City lacked a basis for paying the contractors.

Files for 23 of the 29 homes we originally selected did not contain signed certificates of completion and acceptance. Only six files had signed certificates. Two other files had forms, but the homeowners had not signed them. Although certificates for 23 homes were unsigned or missing, the City paid contracts in full for the 27 properties we inspected.

The former Director and City Specialist made conflicting statements about why the City paid the contractors. The

former Director told us that he paid the contractors for work that the City Specialist approved as completed. He said the Specialist submitted a form showing the work completed and the amount payable to the contractor. However, payment vouchers in the City accounting department were supported only by contractor invoices, not inspection or payments forms.

The City Specialist told us that a certificate of completion and acceptance was not completed for most of the homes because no final inspection was made. The City Specialist told us that the former Director authorized the City to pay the contractors. The Specialist did not know why the former Director authorized the payments without certificates of completion and acceptance. The Director told us that the former Director circumvented requirements at his discretion.

Finally, the former Director used an unapproved volunteer inspector to inspect some homes. The City operated a volunteer program allowing approved citizens to work for the City. The City volunteer program director, however, never approved the volunteer inspector working for the former Director. The unapproved inspector had certified that work our Construction Specialist found incomplete had been completed.

City administrative controls were not effective

Several aspects of the City's administrative controls were deficient. The City did not use its waiting list, obtain required liens, and document the incomes of homeowners.

The City did not use its waiting list. The City placed qualified rehabilitation applicants on a waiting list in the order received. The waiting list was to provide an equitable basis for selecting applicants. The City, however, did not use the waiting list as required by its policies and procedures. A City Housing Counselor said the City did not rank the applicants. She said the former Director selected applicants at his discretion. Because the City did not use an equitable basis for choosing applicants, it denied eligible and needy applicants equitable treatment.

Liens were not filed. The City did not place required liens against five of the rehabilitated homes. The City's policies

and procedures required the filing of a lien equal to the rehabilitation cost. Liens established legal claims against the property owners. Without liens, the City lacked recourse in the event the owners sold their properties before the required occupancy of eight to ten years.

One promissory note was not executed. The City did not obtain a promissory note for one home. The City's policies and procedures required that the homeowner sign a promissory note for the rehabilitation costs. The promissory note would have allowed the City to recover the rehabilitation costs if the homeowner sold the property before an agreed upon time. This property was one of the five for which the City did not file a lien. A mortgage company foreclosed on the property. Because the City had failed to file a lien and obtain a promissory note from the homeowner, it lacked a basis for obtaining reimbursement for the rehabilitation costs.

Low-and moderate-income benefit was not documented. Three of the 29 rehabilitation files we reviewed did not document any verification of the homeowners' incomes. The City's policies and procedures required verification. Without documentation of homeowners' income, HUD and the City had no way to determine whether the rehabilitation work met the national objective of benefitting low and moderate-income persons.

Why administrative deficiencies existed

We attribute the administrative deficiencies to the former Director's failure to ensure compliance with program requirements. A City Housing Counselor, who was responsible for maintaining the waiting list, told us that the former Director approved whomever he wanted despite their waiting list position. The former Director acknowledged that he did not select homeowners in the order of the waiting list. Further, a Housing Counselor told us that there was a high turnover of the staff responsible for obtaining homeowner income information and filing liens; therefore, some duties were not always done.

The Director concurred with our audit results

We provided the Director of the City's Community Development Department and HUD's Ohio State Office staff with the inspection results. The Director agreed with our inspection results and analysis of the City's program.

The City Specialist, however, disagreed in general with our inspections. He attributed the rehabilitation deficiencies to the former Director's verbal instructions to ignore certain code violations. He did not, however, dispute any specific deficiency we identified. We also discussed the results of our inspections with HUD's Ohio State Office staff. They concurred with our findings.

The Director did not want to correct the violations we cited. She said it would be too costly to bring some homes up to code. She would rather use the money to rehabilitate other homes rather than pour more money into properties that the City probably should not have selected in the first place. The Director said the City should not have selected homes that were too costly to rehabilitate.

We agree that bringing the homes into compliance with the City's code may be costly. However, we believe that the City has an obligation to the homeowners to correct code violations as it had originally committed to do.

The City planned to administer the rehabilitation program

The City planned to administer future rehabilitation work itself. The Director had revised some policies and procedures for administering rehabilitation programs. By revising policies and procedures, the Director made a positive effort to correct the rehabilitation program deficiencies. In our opinion, however, the City's revised policies and procedures alone will not correct the problems. Instead, the City must ensure that staff can operate the rehabilitation program.

The results of our audit showed that the staff who inspected the 27 homes in our sample were not capable of operating the program. In 1994, at the request of HUD's Ohio State Office, the City engaged a local housing organization to administer the program. HUD praised the decision to use an outside agency to administer the program. We concurred with the decision.

During our audit, the Director said the City had new employees who were capable of completing the initial inspections, writing specifications, and assuring that contractors completed the required work. We have no basis to evaluate the Director's statements concerning the new

staff. Therefore, HUD's Ohio State Office must evaluate whether the City's new staff can administer the program. If HUD's Ohio State Office determines that the new staff are capable, then the City should be allowed to administer the rehabilitation program. If HUD determines that the City's new staff are not capable, the City should continue to use an outside qualified organization to do certain functions such as initial inspections, write-up of work specifications, and final inspections. Therefore, HUD's Ohio State Office must work closely with the City and find out the new staff's capabilities.

Auditee Comments

The City has supplied to the Inspector General's office resumes and background materials for new designated positions of Housing Program Manager and Construction Manager. These individuals will work with the established Housing Rehabilitation Specialist and Housing Counselor. The Housing Program Manager's background includes specification writing and experience in construction management and housing rehabilitation. The Housing Program Manager will work with the City's Chief Building Official. The Chief Building Official holds Plumbing and Electrical Certificates under authority of the Ohio Basic Building Code. The Housing Construction Manager has experience in housing maintenance and as a housing inspector for three years. The City's Housing Rehabilitation Specialist and Housing Counselor report directly to the Housing Program Manager. Together, these parties monitor each other's work for accuracy and code compliance. This team approach also will monitor the City's waiting list and make certain that liens and required promissory notes are executed. In this way, the City is confident that by generating daily inspection reports, proposed specifications for any rehabilitation assignment may be reviewed for accuracy and code compliance before solicitation of bids for construction.

OIG Evaluation of Auditee Comments

The City's response states, in essence, that the new staff is qualified and is going to correct the deficiencies described in our finding. The new staff has not been involved with the City's rehabilitation program. Therefore, we are recommending that HUD's Ohio State Office evaluate the new staff's capability to administer the program.

Auditee Comments

Simply put, we concur with the observation that constant management of the Housing Rehabilitation Program is required. If there are members of the Community Development Department that are unable (or incapable) of performing their official duties as anticipated and required, a detailed performance evaluation outlining these deficiencies, including progressive discipline, will be implemented. The City pledges to continue working closely with HUD officials with the Ohio State Office to ensure compliance.

OIG Evaluation of
Auditee Comments

The City's response shows that the City intends to monitor closely its staff and work with HUD's Ohio State Office to insure compliance with program requirements. We believe these are positive steps.

Auditee Comments

The City supports any recommendation that those contractors that have done incomplete or defective work should be suspended temporarily from participating in the City's Housing Rehabilitation Program.

OIG Evaluation of
Auditee Comments

The City should provide HUD with sufficient documentation to support a temporary denial of participation of those contractors paid for incomplete and defective work.

The City did not address our recommendations to: correct code violations, do costs estimates and analyses, provide training to staff. It also did not comment on controls for: paying contractors, determining family income, selecting applicants, ensuring rehabilitation costs are reasonable, proofreading work specifications, and rejecting or accepting contractors. Finally, the City did not comment on the recommendations to repay \$55,551 for incomplete, defective, and duplicate work.

Recommendations

We recommend that the Ohio State Office's Director of Community Planning and Development Division instructs the City to take the following corrective actions:

- 1A. Correct the incomplete and defective work particularly those items that are immediate health and safety issues. No future rehabilitation work should be done until these items are completed or the City can demonstrate that it has sufficient funds to correct the items and do new rehabilitation work.
- 1B. Correct the code violations that City specifications did not require to be corrected, particularly those violations that are dangers to the tenants' health and safety.
- 1C. Prepare cost estimates and analyses in the future for specification work items. The City should negotiate a price reduction for work items with unreasonably high prices.
- 1D. Train the rehabilitation staff in identifying code violations and preparing specifications to correct them. The training should emphasize violations related to electrical and plumbing systems.
- 1E. Develop controls to pay contractors only for work that has been completed correctly and passed inspection. An inspection progress report or certificate of completion should accompany requests for payment.
- 1F. Implement quality control procedures to assure that required family income information is obtained and recorded in the rehabilitation files, contracts are signed, promissory notes are obtained, liens are filed, and homeowners sign certificates of completion and acceptance.
- 1G. Establish a waiting list and select eligible and needy applicants from the list in the order the applications were received, unless, the City can demonstrate an alternate and equitable basis for selecting applicants. An example of an alternate basis, may be the selection of a home with a dangerous electrical hazard.

- 1H. Implement procedures to prevent the City from rehabilitating homes when the costs exceed established price thresholds.
- 1I. Implement procedures to assure that work specifications are proofread before bids are solicited.
- 1J. Evaluate the competency of contractors paid for substandard work. Incompetent contractors should not be awarded future work.
- 1K. Repay the Block Grant Program \$55,551 for the incomplete, defective, and duplicate work items in the specifications.

We also recommend that the Ohio State Office's Director of Community Planning and Development:

- 1L. Provide oversight to the City in its selection of incomplete, defective, and uncorrected code violations that are immediate health and safety issues.
- 1M. Evaluate whether the City's new staff is capable of administering the rehabilitation program. If it is determined that the new staff is not capable, the City should continue to use an outside agency to do initial inspections, write work specifications, and perform final inspections.
- 1N. Instruct the City to submit documentation to support a temporary denial of participation for contractors paid for incomplete and defective work.

The City Paid for Ineligible and Unsupported Costs

The City of East Cleveland paid \$42,657 of Community Development Block Grant money for ineligible and unsupported costs. The ineligible costs consisted of \$16,765 for indirect costs that should have been charged to other programs, and \$18,887 for non-Block Grant activities. The City also did not have invoices to document \$7,005 worth of payments. The Director said the previous Director during 1993 and 1994 did not follow policies and procedures. More critically, the City had not set up procedures to ensure proper payments. As a result, less money was available to pursue Block Grant Program objectives. On the positive side, the City improved its payment procedures during 1995.

HUD Requirements

HUD Regulation 24 CFR 570.200(a)(2) requires that, for costs to be eligible for Block Grant assistance, grantee programs must meet one of three national objectives. In brief, to meet a national objective Block Grant payments must: 1) benefit low or moderate income families; 2) eliminate or prevent slums or blight; or (3) remedy an urgent need.

HUD Regulation 24 CFR 570.207(a)(1 and 2) states that buildings for general government activities cannot be assisted with Community Development Block Grant funds. Similarly, payments to carry out the regular responsibilities of the unit of general local government are not eligible for assistance.

HUD Regulation 24 CFR 570.501(b) states that the recipient is responsible for ensuring that it uses funds according to program requirements. The use of a subrecipient does not relieve the recipient of this responsibility.

HUD Regulation 24 CFR 570.506(b) describes the documentation that must be maintained. Some examples are: records showing that each activity meets one of three national objectives, information on income by family size,

and evidence establishing that assisted persons qualify as low or moderate income persons or households.

Block Grant paid for ineligible costs

Based on indicators from HUD's monitoring reports and our survey, we judgmentally selected and reviewed 165 payments made from January 1993 through March 1995. As the table below shows, the City spent \$42,891 for ineligible purposes. It repaid \$7,239 to the Block Grant Program, leaving net ineligible costs totaling \$35,652.

Description	Amounts
Excess indirect building cost	
- Telephones	\$ 15,953
- Gas and electric	6,638
- Building and equipment maintenance	<u>1,413</u>
Subtotal	\$ 24,004
-Reimbursement to Program	<u>(7,239)</u>
Net excess indirect cost	\$ 16,765
Other ineligible cost	
- Holiday season lights and decorations	9,980
- Mayor's membership dues	3,499
- Dinner for recipients and city-wide picnic	2,739
- Airfare to Jamaica	2,313
- Vehicle accessories	<u>356</u>
Total ineligible cost	<u>\$ 35,652</u>

Indirect costs were not allocated among departments

The City overcharged the Block Grant Program \$24,004 for indirect expenses that it should have charged to other City departments and programs. HUD's Ohio State Office noted the apparent overcharges in its monitoring report dated November 1994. As a result, the City refunded \$7,239 to the Block Grant Program. The HUD Office requested that we find out the amount the City still owed the Block Grant Program.

To calculate the telephone overcharge to the Block Grant Program, we used the ratio of telephone lines the Community Development Division used to the total lines used by the City. The overcharge for telephones was \$15,953. The City had been charging 25 percent of its base

telephone costs to the Block Grant Program. However, based on the number of telephone lines used by the Block Grant Program, charges should not have exceeded 11 percent of the City's base telephone charges.

Similarly, for other utilities and maintenance we used the percentage of the office space occupied by Community Development compared to the total usable office space in the building. During its 1994 review, the HUD Office estimated that the Community Development Department occupied 60 percent of the building's office space. We reviewed HUD's analysis and concurred with its assessment.

Based on Community Development's occupancy, the City charged the Block Grant Program \$8,051 for utility and maintenance costs that it should have charged to other departments. The Community Development Department shared a building at 13601 Euclid Avenue with two other departments, the Building and Engineering Department and the Housing Department. Community Development was the only department with indirect costs allocable to the Block Grant Program. The City, however, charged the Block Grant Program 100 percent of the building's costs for gas and electric and for maintenance.

As a result of a HUD monitoring report, the City paid the Block Grant Program \$7,239 as partial reimbursement for the overcharges. The reimbursement reduced the excess indirect costs to \$16,765 from \$24,004. The City also revised its allocation methods to charge the Block Grant for only 11 percent of the City's base telephone bill and 60 percent of the common gas, electric, and maintenance costs.

Block Grant paid for other ineligible cost

The City paid \$18,887 for other ineligible expenses related to general local government and other ineligible activities. The City spent \$9,980 of Block Grant Program funds to put up lights and decorations throughout the City during the 1993 and 1994 holiday seasons. The City lacked documentation identifying the national objective and eligibility requirements met. The Director agreed that this program did not meet a national objective and told us that the City will not fund the program in the future.

The City reimbursed a subrecipient \$2,313 for airfare to send youngsters to an exhibition boxing match in Jamaica. The request for reimbursement did not state how the children benefitted, whether they were from low or moderate income families, or identify the eligibility requirement met. Regardless, the cost of the trip was not a reasonable and economical use of Block Grant funds. The HUD Community Planning and Development Division agreed with this assessment.

In 1993, the City paid \$3,499 of Block Grant Program money for the Mayor's membership dues to the Northeast Ohio Area-wide Coordinating Agency. The Director agreed that the dues were not an eligible expense. She declined to pay the Mayor's 1994 and 1995 membership dues.

In 1993, the City charged \$2,739 to the Block Grant Program for a dinner for Block Grant recipients and a picnic in the park for the entire city. The former Director authorized the payments. The Director said the purpose was other than to reach out to Block Grant participants. The Director concurred that the payments were not eligible.

The remaining \$356 of ineligible costs were for accessories for vehicles used by other City departments not involved in Block Grant activities. The accessories included a hitch, hitch ball, heavy duty flasher, and alarm system. The Community Development Director and the Financial Analyst said the City should not been paid these costs with Block Grant money.

The City did not adequately support payments of \$7,005

The City did not adequately support three payments totaling \$7,005. The unsupported payments consisted of \$5,900 paid to a contractor for demolition; \$955 paid to a home improvement store; and \$150 paid to the petty cash fund of another department.

The City's Finance Department did not have invoices, receipts, or statements of work completed to support the payments. The Assistant Finance Director said the support must have been misplaced.

The Director has implemented improved controls

The Community Development Director officially was appointed in December 1994. During our audit, we concluded that the Director had improved policies and procedures for payments. Our testing showed that ineligible and unsupported payments decreased substantially in 1995. Our review of 1995 payments turned up only \$249 of ineligible costs.

The Director's most important improvement was that she was reviewing all payment requests for compliance with Block Grant Program requirements. In addition, the Director started to require subrecipients and other City departments to submit supporting documentation before paying them.

Auditee Comments

The City has a reasonable explanation to those asserted ineligible and unsupported costs funded by the Community Development Block Grant. Additional receipts and documentation, which apparently were previously unavailable, have been supplied to the Inspector General for Audit during the exit conference on September 12, 1995.

Thus, the City appears to have adequate support for \$34,609 of the asserted ineligible and unsupported costs. Therefore, the City respectfully requests that the Inspector General for Audit find no violation of applicable HUD regulations as to these items.

OIG Evaluation of Auditee Comments

Based upon the information provided by the City we reduced the amount of unsupported costs by \$28,754. The City did not provide adequate support for disbursements totaling \$7,005. Specifically, the City did not provide invoices for payments of \$5,900 for demolition, \$955 to a retail store, and \$150 to a petty cash fund.

Auditee Comments

The reality is that the City's general fund is incapable of directly repaying any identified ineligible cost without risk of substantially impairing the City's ability to provide essential public services to its citizens. Simply put, the City lacks the unencumbered resources in its general fund to repay any of the costs determined to be ineligible.

The City is most interested in pursuing discussions with the Inspector General for Audit or the Ohio State Office to establish a process by which the City may reduce the identified unsupported costs from future allocations under the Community Development Block Grant funding process. This may be the preferred method of resolving this matter as the City of East Cleveland must continue directing its limited general fund resources toward maintaining essential governmental services.

OIG Evaluation of
Auditee Comments

Reduction of future grants for ineligible and unsupported costs is an alternative to direct repayment. The City should pursue this alternative with the Ohio State Office.

Recommendations

We recommend that the Community Planning and Development Director requires the City of East Cleveland to:

- 2A. Reimburse the Community Development Block Grant Program \$16,765 from non-Federal funds for indirect costs that should have been charged to other City departments.
- 2B. Reimburse the Community Development Block Grant Program \$9,980 from non-Federal funds for the lighting and decorating program.
- 2C. Reimburse the Community Development Block Grant Program \$3,499 for an ineligible payment of the Mayor's dues to an area organization.
- 2D. Reimburse the Community Development Block Grant Program \$2,739 for the dinner and the picnic for the City.
- 2E. Reimburse the Community Development Block Grant Program \$2,313 from non-Federal funds for the airfares to Jamaica.
- 2F. Reimburse the Community Development Block Grant Program \$356 for accessories for vehicles used by other City departments.

- 2G. Provide adequate support for payments of \$7,005 made to contractors, a retail store, and a petty cash fund. If documentation is unavailable, the unsupported amounts should be repaid to the Community Development Block Grant Program from non-Federal funds.

- 2H. Establish adequate procedures to ensure that future program charges are eligible and supported.

(THIS PAGE LEFT BLANK INTENTIONALLY)

The City of East Cleveland Lacked Effective Internal Controls

The City of East Cleveland did not implement effective internal controls over its Community Development Block Grant Program. The City did not monitor subrecipients to ensure that Block Grant money was spent in compliance with Federal requirements. The City also did not segregate the duties of the accounts payable clerk, limit access to its check signing machine, and obtain audits timely. The Director of the Community Development Department took over her responsibilities in December 1994. She told us that there were so many issues to address that she could not resolve them all over night. As a result, the City could not ensure that Block Grant money was spent for eligible purposes and economically and efficiently.

Internal Control Standards

The United States General Accounting Office publication, *Assessing Internal Controls in Performance Audits*, cites the following relevant control standards:

- Managers and employees always are to show a positive and supportive attitude to internal controls.
- Access to resources and records is to be limited to authorized individuals. Accountability for the custody and use of resources should be assigned and maintained. Periodic comparison shall be made of the assets with the accounting records to find out whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.
- Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.
- Internal control systems are to provide reasonable assurance that objectives of the system will be met.

HUD Requirements

24 CFR sections 85 and 570 address the various requirements for safeguarding Block Grant funds.

- The recipient is responsible for ensuring the Block Grant money is used in accordance with Program requirements.
- Each recipient must maintain sufficient records that a national objective was met.
- Salaries allocated to the Block Grant Program are charged according to the amount of time spent on Program activities.

The City did not monitor subrecipients and other City departments

The Community Development Department staff did not monitor subrecipients and other City departments receiving Community Development Block Grant money. 24 CFR section 85.40(a) states that grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are achieved. Section 570.506 states that each recipient shall maintain sufficient records to enable the Secretary to find out whether the recipient has met requirements on national objectives.

The Community Development Department was responsible for administering the Block Grant Program. The value of monitoring was to find out whether subrecipient activities met program requirements and objectives. Monitoring may be in the form of reviewing subrecipient performance reports submitted to the City, or reviewing documentation at the subrecipient during on-site monitoring visits. Community Development staff told us the former Director did not implement a monitoring function. Therefore, the Community Development Department did not obtain documentation to support that the subrecipient's and other City department's activities paid for with Block Grant funds met a national objective.

The Community Development Department did not obtain performance reports from its subrecipients and other departments for its 1993 program year. The City obtained performance reports from subrecipients and other departments in 1994. The reports, however, did not support whether the activities met a national objective.

In addition, the City had not conducted monitoring visits. Therefore, it could not have determined whether subrecipient activities paid for with Block Grant money met a national objective. Without performance reports or direct verification from monitoring visits, the City cannot provide HUD with documentation to show that \$368,608 in Block Grant funds were spent on eligible activities.

The City did not segregate employee duties adequately

The City's Finance Department did not segregate the duties of its accounts payable function. The accounts payable clerk was responsible for processing all invoices and disbursements including those for the Block Grant Program, reconciling vendor accounts, and entering payroll data. Because of the Finance Department's small staff size, the Assistant Director said the employee, at the request of the former Director of Finance, was trained to do all aspects of a function. However, we believe the Finance Department staff of six was adequate to allow a reasonable segregation of the duties for the accounts payable function.

Also, contrary to the duties assigned to the Accounts Payable clerk, no one individual should have control over all key aspects of a transaction or event. Controls, such as segregation of duties, should be designed to reduce the possibility of wrongful acts going undetected. Inadequate segregation of duties allows for the possibility of unauthorized payments to vendors or employees and the possibility of collusion among employees. As a result, the City could not assure HUD that Block Grant money was adequately safeguarded from waste, loss, and misuse.

The City did not adequately safeguard access to the check-signing machines

The City did not safeguard the key to the check-signing machines. The City kept the key in a deposit box. However, the key to the deposit box hung on a hook inside the door of a walk-in vault. The key was easily accessible to all employees of the Finance Department and other City departments. The City used its check signing machines for all disbursements including those from Block Grant funds.

The Assistant Finance Director said only authorized personnel would know which key opened the safe deposit box. However, easy access to the safe deposit key, increased the risk that unauthorized persons could have access to the check signing machines.

Employee's salary was not allocated among city departments

The City did not have a system for allocating salaries between the Block Grant and other programs. Such a system was necessary to charge the Block Grant Program correctly. 24 CFR section 570.206(a)(1) states that in charging salaries to the Block Grant Program, the recipient may either include the entire salary and related costs allocable to the program whose primary responsibility is to administer the program or pro rate a share of the salary. The following example illustrates why the City needed an allocation procedure.

The City charged the total salary of an employee to the Block Grant Program while the employee also worked for other City departments. The employee's self evaluation, completed as a part of her annual review, showed that besides the Block Grant Program, the employee worked for the Building and Engineering Department and the Housing Department. The work included typing and switchboard duties. Documentation was not available to figure out the amount of time the employee spent performing duties for the other departments. The Director said she was not aware the employee did work other than for the Block Grant Program.

During our audit, the Director of Community Development developed a system to account for each employee's job activities. The system required all employees in the Community Development Department to complete a time allocation sheet daily. The sheet showed the amount of time spent on each activity. It was then used by the Financial Analyst to allocate the employees' salaries to the correct program, based on the percentages identified on the time sheets. Such procedures are positive and adequate to ensure that salaries are allocated properly.

The City did not submit required audits timely

Office of Management and Budget Circular A-128 "Audits of State and Local Governments" states that local governments receiving \$100,000 or more in a year in Federal funds must have an audit made for that year. The audit reports shall be sent no later than one year after the end of the audit period.

The City did not obtain the required audits timely. The single audit report for the year ended 1992 was issued in

February 1995. The report should have been issued within one year from the end of the fiscal year, December 31, 1992. As of August 15, 1995, the 1993 and 1994 audits had not been completed. Annual financial audits are important because they provide reasonable assurance whether the City's financial position is presented fairly. The Finance Director who the City recently hired, said the City had a history of not having the financial statements done timely.

Prior to hiring the new Director, the City did not have staff sufficiently knowledgeable to convert its financial statements to the required generally accepted accounting principles. As a result, the State Auditors Office has not been able to complete the annual financial audits. The Finance Director said she would work toward making sure the audits are done timely.

Auditee Comments

The Director has revised the Subrecipient Agreement to include a detailed scope of services and procedures to monitor expected performance. A subrecipient technical assistance session was held in May 1995 to distribute these revised contracts, including copies of applicable HUD regulations, and newly designed monthly monitoring reports. Monthly monitoring reports are due from all subrecipients by the 5th day after the close of the following month. Monitoring reports are further expected to track how many low and-moderate income persons are being served and how these participants support the stated scope of services. Payments are withheld if monitoring reports are not received timely. Subrecipient including City Departments monitoring visits began during the Third Quarter of 1995. The Finance and Community Development Departments have worked closely to ensure strict compliance in this area. All monitoring visits are documented and evidence noted that subrecipient activities are eligible.

The Community Development Director will attempt to secure documentation from all subrecipients (including City Departments) for the 1993 and 1994 Program Year to ensure that Community Development funds were spent according to applicable guidelines.

Based on recent correspondence from the HUD Ohio State Office the subrecipient management actions of the current Director, Community Development, have positively addressed identified concerns in this area.

OIG Evaluation of Auditee Comments

The City has made efforts to improve the controls over monitoring of subrecipients. The City had started conducting monitoring visits; however, it had not completed all monitoring visits at the time of our exit conference on September 12, 1995.

We concur with the City's proposal to attempt to secure documentation from subrecipients. If the City does not obtain adequate supporting documentation, however, it should repay the Block Grant Program.

The HUD correspondence referred to in the comments was dated September 1, 1995. The letter stated that the City had made progress in developing a plan for subrecipient monitoring. The letter also stated that the progress related to subrecipient monitoring would be reviewed by HUD in the future.

Auditee Comments

The City's internal controls for the Accounts Payable responsibilities are as follow:

- a. The Receptionist/Telephone Operator sorts incoming mail or invoices and places them in the appropriate Department's mailbox.
- b. Each Department Head is responsible for reviewing each invoice and matching these documents to the City generated Purchase Order prepared by the Purchasing Agent. The Department Head approves each invoice for payment and submits the invoice plus the gold copy of the Purchase Order to the Accounts Payable Clerk. Invoices are time-stamped in the Finance Department, then placed in the Accounts Payable Clerk's payment box. The Accounts Payable Clerk inputs data into the system for payment. The City maintains a standard operational cycle for issuing checks for vendor payments on the 15th & 28th day of each month.

- c. If the Accounts Payable Clerk erroneously receives invoices intended for other City Departments, these invoices are returned immediately to the Receptionist for proper placement or rerouting. Thus, the City believes that more than adequate controls exist in this area, since the processing of invoices occurs at the Departmental level. For example, additional compensating controls the City has implemented are as follows:

The Finance Director periodically reviews invoices before the disbursement cycle to ensure the City remits payments in the desired thirty day cycle;

The Accounts Receivable Clerk separately prepares the outstanding check list for the general operating account; and

The Assistant Finance Director/Chief Accountant separately does the monthly bank check reconciliation and proof of cash statement.

The Finance Department plans to implement additional compensating controls to the extent possible to assure that the accounts payable Clerk's duties are adequately segregated.

OIG Evaluation of Auditee Comments

The compensatory controls described in the City's response would improve internal controls over the accounts payable function. The controls as described in the response, however, were not sufficient to compensate fully for inadequate segregation of duties. The Finance Director's periodic review of invoices before disbursement are made would not necessarily prevent the issuance of false checks after her review. The other controls described in the comments are procedures designed to reconcile the City's books of accounts and bank statements. They do not prevent or necessarily detect falsified invoices or checks because the person who processes the invoices also processes the disbursements. Therefore, we agree with the City's intention to implement stronger compensatory controls.

Auditee Comments

Only the personnel of the Finance Department are permitted in the City's vault -- where the check signing machine is stored. Any non-Finance Department employee must be accompanied by a Finance Department staff person. The City maintains 12 safety deposit boxes of which only one box contains the key to the check signing machine. Inside the vault, the Finance Department maintains approximately 50 or more keys. Any non-Finance Department person must know the specific deposit box and its identified number to find the key that accesses the safe deposit box. The keys to the deposit boxes are not in numerical sequence.

A log is maintained for all City disbursements that includes date and check sequence and is initialed by the Finance Department staff person making the disbursement request. Because of the small size of the Finance Department staff and limited access to the Department itself and the locked/buzzer security system, the City believes sufficient controls are in place to safeguard from waste, loss, and misuse of Community Development Block Grant funds.

The Finance Department plans to set up additional compensating controls to the extent possible to assure that the check-signing machine is adequately safeguarded against theft, loss, and misuse.

**OIG Evaluation of
Auditee Comments**

A knowledgeable person such as the accounts payable clerk can easily identify the keys to the safe deposit box and the check signing machines. Therefore, the keys to the machines should be secured and access limited to authorized personnel only.

The City's plan to implement additional compensatory controls is a step to ensuring the safeguarding of the check signing machines. However, the City's comments did not describe any additional controls. Therefore, we can evaluate their effectiveness.

Auditee Comments

The employee in question is a Secretary/Administrative Assistant. Her full-time duties now include answering the

switchboard approximately four hours a day, not to exceed 60 percent of the entire switchboard coverage time. All employees paid from Block Grant funds or who work on Block Grant projects, are required to fill out allocation sheets supporting the use of time. In those limited situations where employees are out sick, on vacation, or on leave of absence, an employee may be asked to fill in or perform an essential function. However, for the present and in the future, those hours will be noted on the time allocation sheet and charged to the proper City department.

OIG Evaluation of
Auditee Comments

The City's use of time allocation sheets is a step to more accurately charging the Block Grant Program.

Auditee Comments

The Finance Director started her position on April 18, 1994. Since then she has aggressively addressed any identified noncompliance issues within the Department of Community Development. The Director of Finance currently prepares the City's generally accepted accounting principles conversion internally with technical assistance from an outside accounting firm. The Finance Department is working diligently to maintain current audited financial statements.

The Finance Director is currently performing the 1994 generally accepted accounting principles conversion. Once completed, the City believes this area will be in full compliance.

Recommendations

We recommend that the Community Planning and Development Director requires the City of East Cleveland to take the following corrective actions:

- 3A. Submit documentation to show that \$368,608 of activities performed by subrecipients and other City departments during 1993 and 1994 met a national objective and was for eligible program expenses. HUD should require the City to repay the portion of money for which no documentation is obtained.

- 3B. Conduct monitoring visits of subrecipients and other City departments. The visits should be documented and evidence that subrecipient activities are eligible.
- 3C. To the extent practical establish a system that will segregate the duties of the accounts payable clerk.
- 3D. Safeguard the check-signing machines by limiting access to the safe deposit key to authorized personnel.
- 3E. Implement procedures whereby employees' salaries are correctly charged to the Block Grant Program.
- 3F. Implement procedures to convert the City's financial statements to generally accepted accounting principles timely. The conversion should be completed to permit the annual financial audits to be issued within one year of the fiscal year-end.

Internal Controls

In planning and performing our audit, we considered internal systems relating to the City of East Cleveland's administration of the Community Development Block Grant Program, 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 is interrelated components, including integrity, ethical values, competence, and the control environment that includes establishing objectives, risk assessments, information systems, control procedures, communication, managing change, and monitoring.

Relevant Internal Controls

We determined that the following internal control categories related to our audit objectives:

- Management philosophy and operating style.
- Accounting system and controls.
- Management monitoring methods.
- Documenting benefits to low and moderate income persons.

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

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

- Management philosophy and operating Style. The former Director circumvented policies and procedures. Specifically, the former Director authorized payments without supporting documents (see Findings 1 and 2).
- Accounting system and control. The City did not maintain proper controls over disbursements. It used Block Grant money to pay ineligible and unsupported expenses (see Finding 2). In addition, it did not establish controls to safeguard assets (see Finding 3).

- Management monitoring methods. The City's monitoring methods did not adequately ensure that the City achieved the objectives of its rehabilitation program (see Finding 1); and subrecipient activities met a national objective (see Finding 3).
- Documenting benefit to low and moderate income families. The City did not monitor the subrecipients to ensure Block Grant money benefitted low and moderate income persons (see Finding 3). The City did not document in all rehabilitation files that it verified homeowners' income (see Finding 1).

Follow Up On Prior Audits

The last OIG audit report, 81-CH-241-1134, dated July 24, 1981 contained seven findings. There are no open findings from the last audit. The City had not obtained an independent auditor's report for fiscal years ended 1993 or 1994.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Schedule of Questioned Costs

<u>Recommendation</u> <u>Number</u>	<u>Type of Questioned Costs</u>	
	<u>Unsupported 1/</u>	<u>Ineligible 2/</u>
1M		\$55,551
2A		16,765
2B		9,980
2C		3,499
2D		2,739
2E		2,313
2F		356
2G	7,005	
3A	<u>\$368,608</u>	
Total	<u>\$375,613</u>	<u>\$91,203</u>

1/ Unsupported costs are charged to a HUD-financed or insured program or activity whose eligibility cannot be determined at the time of the audit since the 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 by HUD program officials. This decision, besides obtaining supporting documentation might involve a legal interpretation or clarification of Departmental policies and procedures.

2/ Ineligible costs are charged to a HUD program or activity that are not allowable by law, contract, or Federal, State, or local policies, or regulations.

(THIS PAGE LEFT BLANK INTENTIONALLY)

Auditee Comments

Distribution

Secretary's Representative, Midwest
Director, Community Planning and Development, Ohio State Office (2)
State Coordinator, Ohio State Office (2)
Director, Field Accounting Division, Midwest
Field Controller, Midwest
Assistant General Counsel, Midwest
Public Affairs Officer, Midwest
Assistant Deputy Secretary for Field Management, SC (Room 7106)
Acquisition Librarian, Library, AS (Room 8141)
Chief Financial Officer, F (Room 10166) (2)
Deputy Chief Financial Officer for Operations, FO (Room 10166) (2)
Audit Liaison Officer, Office of Community Planning and Development, COM (Room 7228) (3)
Associate General Counsel, Office of Assisted Housing and Community Development, GC
(Room 8162)
Assistant Director in Charge, U.S. General Accounting Office,
820 1st St. NE, Union Plaza, Bldg. 2, Suite 150, Washington DC, 20002 (2)