



**City of Worcester, MA**

**Community Development Block Grant Program**



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SUBJECT: The City of Worcester, MA, Did Not Properly Administer Its Community  
Development Block Grant Program

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the City of Worcester, MA, regarding its administration of its Community Development Block Grant (CDBG) program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 212-264-4174.



July 29, 2013

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## The City of Worcester, MA, Did Not Properly Administer Its Community Development Block Grant Program

# Highlights

Audit Report 2013-BO-1002

### What We Audited and Why

We audited the City of Worcester's administration of its Community Development Block Grant (CDBG) program. We selected the City for review based on a request from the U.S. Department of Housing and Urban Development (HUD), Boston, MA, Office of Community Planning and Development. The objectives of the audit were to determine whether the City established adequate controls to ensure that the CDBG activities were eligible and supported and met a national objective, and whether the City exceeded the 15 percent public service cap.

### What We Recommend

We recommend that the Director of the HUD Boston Office of Community Planning and Development instruct the City to (1) repay more than \$2.1 million in CDBG program funds that was expended for ineligible activities and \$298,303 that was expended over the CDBG 15 percent public service cap, (2) provide documentation to support that more than \$3.9 million in CDBG program funds was expended for eligible activities and used for eligible loans that met a national objective, and (3) reallocate \$153,268 to be used for other eligible CDBG activities.

### What We Found

The City did not properly administer its CDBG program. Specifically, City officials did not (1) ensure that costs paid for under the City's affordable housing, public service, and code enforcement activities were eligible and supported; (2) document and could not show that a national objective was met for several of the activities reviewed; (3) ensure that the public service cap of 15 percent was not exceeded; and (4) ensure that the contracted CDBG revolving loan fund was administered effectively and efficiently and in accordance with HUD regulations. These conditions were caused by a lack of (1) proper internal controls over activity classification, identification of a national objective, and cash disbursements; (2) adequate management and a management plan; (3) City policies and procedures related to CDBG administration and record keeping, resulting in inconsistent guidance; and (4) oversight of subrecipients. As a result, the City paid more than \$2.4 million in ineligible costs and more than \$3.9 million in unsupported costs and must reallocate \$153,268 in unexpended CDBG funds to other eligible CDBG activities.

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## **BACKGROUND AND OBJECTIVES**

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The Community Development Block Grant (CDBG) program was established by Title I of the Housing and Community Development Act of 1974, Public Law 93-383, as amended, 42 U.S.C. (United States Code) 5301. The program provides grants to State and local governments to aid in the development of viable urban communities. Governments are to use grant funds to provide decent housing and suitable living environments and expand economic opportunities, principally for persons of low and moderate income. To be eligible for funding, every CDBG-funded activity must meet one of the program's three national objectives. Specifically, every activity, except for program administration and planning, must

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

The City of Worcester, MA, is a CDBG entitlement grantee. CDBG funds are received from the U.S. Department of Housing and Urban Development (HUD) annually to revitalize neighborhoods, expand affordable housing and economic opportunities, and improve community facilities and services, principally to benefit low- and moderate-income persons. The City's Executive Office of Economic Development administers the CDBG program.

HUD awarded the City more than \$13.7 million in program years 35, 36, and 37.<sup>1</sup> CDBG funds are awarded to City departments, other public agencies, public and private nonprofit entities, and for-profit entities to carry out eligible housing and community development projects within the boundaries of Worcester, MA. The City's goals include to (1) promote a livable, viable, and sustainable community; (2) improve the quality of the existing housing stock; (3) mitigate foreclosures and stabilize City neighborhoods; (4) preserve, maintain, and develop affordable housing opportunities; (5) reduce the number of homeless persons through the provision of supportive housing services; and (6) provide for the educational and social service needs of inner-city, low-income populations.

Program year	CDBG entitlement amount
35	\$4,671,840
36	\$4,947,036
37	\$4,141,185
Total	\$13,760,061

In many instances, the City subcontracted CDBG funds to not-for-profit subrecipients to undertake various neighborhood revitalization efforts. Although we did not review program year 38, which covers the period from July 1, 2012 through June 30, 2013, City officials have been working with

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<sup>1</sup> Program year 35 is from July 1, 2009, to June 30, 2010, program year 36 is from July 1, 2010, to June 30, 2011, and program year 37 is from July 1, 2011, to June 30, 2012.

HUD and Dennison & Associates, a technical assistance consultant provided by HUD, to correct past practices and craft policies and procedures that lay a framework for future management of its programs.

The objectives of the audit were to determine whether the City established adequate controls to ensure that the CDBG activities were eligible and supported and met a national objective, and whether the City exceeded the 15 percent public service cap.

## RESULTS OF AUDIT

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### Finding 1: The City's CDBG Activities Were Not Always Eligible and Supported and Did Not Always Meet a National Objective

The City did not administer its CDBG program in accordance with applicable HUD requirements and its own contract requirements. Specifically, City officials did not ensure that costs paid for under the City's affordable housing, public service, and code enforcement activities were properly classified, eligible, and supported. Officials also did not document and could not show that a national objective was met for several of the activities reviewed. This condition was caused by a lack of (1) proper internal controls over activity classification, identification of a national objective, and cash disbursements; (2) adequate management and a management plan; (3) City policies and procedures related to CDBG administration and record keeping, resulting in inconsistent guidance; and (4) oversight of subrecipients. As a result, the City expended more than \$2.1 million in ineligible costs and more than \$3.2 million in unsupported costs for activities that may not have met the intended national objective. Further, \$153,268 in unexpended funds could be reallocated to other eligible CDBG activities (see appendix C for breakout by agency and activity).

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#### **Affordable Housing Activities Not Eligible or Supported**

The City contracted with various community development corporations<sup>2</sup> under its affordable housing production program.<sup>3</sup> The CDBG contracts were for project delivery costs, but the contracts were not project specific and did not include quantifiable performance indicators in subrecipient agreements or adequately track subrecipient performance in accordance with regulations at 24 CFR (Code of Federal Regulations) 570.503(b)(1). The City also did not indicate which national objective the agencies would meet in the City's subrecipient agreements. Further, the City had no documentation to show how many affordable housing units the corporations produced or how the agencies met a national objective in each contract year. The corporations' project cash requests were submitted to the City without documentation supporting what activity was performed or which projects were worked on.

In addition, the City did not perform adequate monitoring of the agencies in accordance with 24 CFR 85.40(a). Although City officials performed annual monitoring of the corporations, the monitoring was not detailed and did not include a review of the projects completed or in process, and when issues were

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<sup>2</sup> Worcester East Side CDC (Community Development Corporation), Worcester Common Ground CDC, Oak Hill CDC, and Main South CDC

<sup>3</sup> Alternately known as the housing stabilization program and collectively known as the affordable housing program.

identified; officials did not perform follow-up monitoring to ensure that they were corrected. We were informed that the City's housing responsibilities had been restructured over the past few years by creating a new, independent division, replacing underperforming staff, and adding professionals, including a compliance position, with strong housing development and Federal funding backgrounds. However, at the time in question, the City's CDBG housing department consisted of only the director and one staff assistant, yet the majority of the CDBG funds were allocated to affordable housing programs.

A HUD monitoring review in June 2012 disclosed various findings related to this program, including the misclassification of program delivery activities as housing production activities. As part of the corrective action, HUD allowed the City to give the corporations an opportunity to support the costs by allocating the CDBG funds to specific projects or activities that the corporations worked on, and we reviewed the additional information as part of this audit. As with the above, we noted that in some instances the CDBG projects submitted by the corporations were not eligible projects as they did not meet a national objective. Also, several of the projects' developer fees and overhead costs for the projects deemed eligible exceeded the maximum allowable amount.<sup>4</sup> Therefore, as a result of the above and based on our testing of the additional information provided, the City expended \$1,324,583 on ineligible costs that did not meet a program objective or were not reasonable because they exceeded the allowable amount for the developer fee. In addition \$652,444 allocated to projects deemed eligible is considered unsupported until further review and determinations are made, including verification of sources and uses and a subsidy-layering review for each project that received funding from various sources. Further, \$54,420 in unexpended funds should be reallocated to other eligible CDBG activities (see appendix C).

The City also contracted with the Worcester Community Housing Resources agency to pay for professional direct services and affordable housing lending. The agency was contracted to make loans to property owners trying to rehabilitate their properties, as well as to receivers to maintain properties and bring them up to code. However, in several instances, the administrative fees charged to the CDBG program to process the loans equaled or greatly exceeded the amount of the loan. For example, the agency processed a loan for \$579 and charged the CDBG program \$6,652 in administrative fees. This was not a reasonable expense for administering these loans. Further, the City did not possess adequate records to demonstrate compliance with HUD requirements in meeting the national objective. Therefore, the City did not know whether the loans made were CDBG eligible and whether the terms of the loan met CDBG requirements (see finding 3).

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<sup>4</sup> The developer fee and overhead were limited to 5 percent of acquisition costs and 12.5 percent of hard and soft development costs.

Worcester Community Housing Resources was also contracted to assess the rehabilitation costs and feasibility of the housing receivership appointments based on requests from the City's Department of Inspectional Services and Division of Housing Development. The agency charged administrative costs to the CDBG program for receivership services; however, several of the projects did not make it to receivership. Therefore, these projects should not have been charged to the CDBG program until the City had an interest in them and they were in receivership. This was not an eligible CDBG activity as no national objective was met.

The agency also did not have a fee schedule for this service as the contract was set up to pay a certain percentage of the employees' salaries and fringe benefits. However, when the agency tried to support the costs charged to the CDBG program, it based its administrative costs on the actual or estimated rehabilitation costs. If the property did not go into receivership, the administrative costs charged to the CDBG program were not allowed. As a result, the City disbursed \$575,356 on an ineligible activity as a national objective was not met. In addition, \$216,695 is considered unsupported until further review and determinations are made, including obtaining beneficiary data to support that it met a national objective by serving low- and moderate-income individuals. Thus, the remaining \$62,699 in unexpended funds should be reallocated to other eligible CDBG activities (see appendix C).

The conditions described above occurred because the City did not (1) properly execute its CDBG contracts with the agency, (2) have City policies and procedures related to CDBG administration and record keeping, and (3) have adequate oversight of its subrecipients.

### **Public Service Activities Not Supported**

Our review of five public service activities revealed that the City did not possess adequate records to demonstrate compliance with HUD requirements in meeting the national objective for its public service activities. City officials did not maintain adequate supporting documentation to demonstrate that the individuals served were low- and moderate-income persons in accordance with 24 CFR 570.506(b). These conditions occurred because the City lacked effective management controls and adequate monitoring and oversight of its public service activities. Four of the five public service activities reviewed received \$1,509,643; as a result, these funds were considered to be unsupported (see appendix C).

The City did not adequately track subrecipient performance in accordance with regulations at 24 CFR 570.503(b)(1). They did not have adequate procedures in place to ensure that project cash requests contained the proper support according to 24 CFR 570.506(h). The subrecipients submitted project cash requests to the City, but City officials did not receive adequate monthly reports, as required by

the contract, to document the number of unduplicated clients served or the services provided or support to show that the clients were low- and moderate-income. However, City officials continued to process project cash requests and reimburse the subrecipients.

The City also did not perform adequate monitoring of the subrecipients in accordance with 24 CFR 85.40(a). The project monitor performed annual monitoring; however, when issues were identified, City officials did not follow up with the subrecipients or recommend corrective action. The City did not have a management plan or policies and procedures in place to document monitoring procedures for staff to follow. Further, although staffing changed throughout the program years at all four agencies conducting public service activities, there was no notification to the City as provided for in the contract. The contract included a percentage of salary and other expenses to be charged to the CDBG program; however, the percentages charged for employee salaries and other expenses changed throughout all 3 program years for all of the agencies with no explanation for the changes. Although the total amount reimbursed to the agencies did not exceed the contracted amount, it appeared as though the percentages were increased throughout the year to ensure that the agencies received all of the allocated funds. However, City officials did not question the modifications.

According to City officials, starting in January 2013 each project cash request submitted by the public service agencies included the number of unduplicated individuals served and a self-declaration income certification for each new client. The City paid on a per-client basis and only for the number of clients that it could support was eligible. If information was missing, such as name, address, income, client signature, etc., the City did not include the client in the reimbursement.

The fifth public service activity reviewed was Operation Clean City. The scope of work was to clean up public property on an ongoing basis. However, this was not an eligible CDBG expense as it was a general responsibility of the City according to 24 CFR 570.207(a)(2). Further, according to 24 CFR 570.201(e), to be eligible for CDBG assistance, a public service activity must be either a new service or a quantifiable increase in the level of an existing service above that which has been provided by or on behalf of the unit of general local government in the 12 calendar months before the submission of the action plan. The City was not able to document this information. In addition, the contract did not specify which national objective this activity would meet, and there was no supporting documentation to show which national objective this activity met. According to HUD's Integrated Disbursement and Information System (IDIS),<sup>5</sup> the City classified Operation Clean City as limited low- and moderate-income clientele. The City also did not monitor this activity in program years 35, 36, or 37. As of May 2013, the City had paid \$130,512 for salaries and supplies; therefore, we

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<sup>5</sup> IDIS is a nationwide database of current information regarding CDBG activities underway across the Nation, including funding and accomplishment data. HUD uses this information to report to Congress and monitor grantees.

considered this amount to be ineligible since the services provided appeared to have been a general City responsibility and this activity did not meet a national objective. Further, the \$36,149 in unexpended funds for this program should be reallocated and used for other eligible CDBG activities (see appendix C).

### **Code Inspection Activity Not Eligible or Supported**

The City did not demonstrate compliance with HUD requirements in meeting the national objective for its code inspection activity.<sup>6</sup> The contract did not list which national objective the code inspection activity would meet. According to IDIS, the national objective listed was for low- to moderate-income area benefit; however, neither the City’s Executive Office of Economic Development nor the Department of Inspectional Services maintained adequate supporting documentation to demonstrate that the code inspection activity met the national objective. The City did not show whether this activity was targeted at deteriorated or deteriorating areas described by the grantee; that 51 percent of residents of the area were low- or moderate-income persons; and that code enforcement, together with public improvements, rehabilitation, and services to be provided, could be expected to arrest the decline in the area in accordance with 24 CFR 570.202(c).

The Department of Inspectional Services was contracted to provide systemic code inspections in targeted CDBG areas and Neighborhood Revitalization Strategy Areas in coordination with the Executive Office of Economic Development. Specifically, the Department of Inspectional Services, with the approval of the Executive Office of Economic Development, was contracted to identify specific neighborhoods to be inspected and coordinate other services available to improve properties. Additionally, compliant-driven inspections could not be more than 20 percent of total inspections funded with CDBG funds, and source documentation on code complaints had to be analyzed annually to identify targeted code enforcement priorities. The Department of Inspectional Services also was required to continue with neighborhood sweeps when necessary. However, neither the Executive Office of Economic Development nor the Department of Inspectional Services could provide documentation to support which objective was being achieved.

According to the contracts, the City allocated more than \$1 million for salaries and fringe benefits for Department of Inspectional Services employees for code inspections and constable services between years 35 and 37. The Department of Inspectional Service did not submit monthly project cash requests as required by the contract. In program year 35, they did not submit cash requests at all; however, officials continued to reimburse the Department of Inspectional

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<sup>6</sup> Code inspection was incorrectly classified under “affordable housing” and not under the CDBG-eligible category known as “code enforcement.”

Services. The City did not receive cash requests in program year 35 but paid the employees based on the information in the City's payroll system.

Further, in program years 36 and 37, the amounts in the project cash requests did not always match those in the contract. Specifically, the project cash requests were not an accurate representation of what the City paid. Based on the project cash requests and the totals in IDIS, it was unclear what was expended. The City provided the amounts expended according to its financial management system, which showed that the City expended a total of \$994,408 for code inspection, \$888,148 for salary and fringe benefits of employees performing inspections, and \$106,260 for constable services. City officials explained that funds were used from previous program years to cover some of the costs, which was why the totals in IDIS did not always match the contracted amounts.

Since the City did not contract for constable services in program years 35 and 36, we considered the \$80,560 expended for constable services in program years 35 and 36 to be ineligible and the remaining \$913,848 paid for code inspection and constable service to be unsupported, for a total of \$994,408 in questioned costs (see appendix C).

Further, in IDIS, the code inspection activity was incorrectly classified as an affordable housing activity, when it should have been classified as code enforcement.

These conditions occurred because the City lacked effective management controls and adequate monitoring and oversight of its activities. City officials did not perform adequate monitoring of the subrecipients in accordance with 24 CFR 85.40(a) as they did not always perform the required onsite monitoring visits. Over the 3-year period, there was only one monitoring visit completed in program year 36. The monitoring report was incomplete, with very little information provided and no follow-up listed. Thus, the City did not have a management plan or policies and procedures in place to document monitoring procedures for staff to follow.

However, City officials had begun to correct the deficiencies for its program year 38 contracts for code inspection. They requested the following corrective actions from the Department of Inspectional Services in program year 38 that must be followed to fund code inspections for future program years. The corrective actions were originally suggested by HUD to the City in October 2012 and required that

- The term "deterioration" is defined for purposes of the regulation.
- Defined maps are created for sweep target areas and code inspection activity that highlights boundaries within which code inspection activity can be carried out.
- There be a sufficient description of the conditions in each area to support a determination that the area qualifies as deteriorating or

deteriorated under the City's definition. This description is dependent on the City's definition of deterioration.

- There is a strategy for using code enforcement, together with other activities, to arrest decline in the area developed. The City already had a separate contract for board up and demolition, which could be used in conjunction with code enforcement.
- Other information is provided as necessary to determine the impact that code enforcement or other activities have on the decline in the area during the time the CDBG-assisted code enforcement is carried out. This requirement includes tracking progress through the completion of activities.

## Conclusion

The City did not follow HUD requirements or its contract requirements for the City's affordable housing, public service, and code inspection activities. This condition was caused by the City's lack of (1) proper internal controls over activity classification, identification of a national objective, and cash disbursements; (2) adequate management and a management plan; (3) policies and procedures related to CDBG administration and record keeping, resulting in inconsistent guidance; and (4) oversight of subrecipients. As a result, the City expended more than \$2.1 million in ineligible costs and more than \$3.2 million in unsupported costs. Further, \$153,268 in unexpended funds could be reallocated to assist other eligible CDBG activities (see appendix C).

## Recommendations

We recommend that the Director of the HUD Boston Office of Community Planning and Development instruct City officials to

- 1A. Repay \$2,111,011 in CDBG program funds that was expended for ineligible affordable housing, public service, and code inspection activities.
- 1B. Provide documentation to support that \$3,292,630 in CDBG program funds was expended for eligible costs by obtaining beneficiary data on the clients served to ensure that the expenses were eligible and met a national objective, verifying the sources and uses and performing a subsidy-layering review as applicable and if such support cannot be provided, repay the amount.
- 1C. Reallocate \$153,268 in unspent affordable housing and Operation Clean City funds to be used for other eligible CDBG activities so that these funds can be put to better use.
- 1D. Continue existing efforts to establish new internal controls to ensure that funds are obligated for eligible CDBG activities that meet a national objective and

are disbursed for costs that are adequately supported in accordance with CDBG program requirements.

- 1E. Continue existing efforts to finalize the draft written management plan and policies and procedures to ensure that CDBG regulations are consistently followed by all City staff.
- 1F. Include in subrecipient agreements quantifiable performance measurement indicators that correspond to the activity and applicable CDBG national objectives.
- 1G. Strengthen subrecipient monitoring procedures to assure HUD that projects comply with HUD regulations and the subrecipient agreement provisions.
- 1H. Update IDIS to ensure that all of the eligible activities funded with CDBG funds are accurately reported.

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## Finding 2: The City Exceeded Its 15 Percent Public Service Cap

The City exceeded its public service cap of 15 percent in program years 35 and 36. This condition occurred because 1) the City misclassified housing counseling activities as housing services and 2) a previously authorized Neighborhood Revitalization Strategy Area plan, allowing certain public services activities to exceed the cap, expired in June 2010 and was no longer valid. As a result, the City exceeded the 15 percent public service cap by \$298,303.

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### **Housing Counseling Costs Improperly Classified**

The City improperly classified \$411,972 of housing counseling as housing services in program years 35 and 36. Housing counseling is an eligible activity as part of the home ownership assistance program carried out under 24 CFR 570.201(n). When housing counseling is part of a home ownership program under this part of the regulations, it is not subject to the public service cap. However, the City was not able to document that the housing counseling was part of an eligible home ownership program. Therefore, the cost incurred for housing counseling, in this instance, needed to be classified as a public service activity, which would cause the City to exceed its 15 percent public service cap.

### **Lack of an Approved Neighborhood Revitalization Strategy Area Plan**

The City also allocated \$55,000 of the previous year's unexpended balances to employment and training costs in program year 36. The City thought this expense was exempt from the public service cap because it was for a Neighborhood Revitalization Strategy Area. However, the City's previously approved Neighborhood Revitalization Strategy Area plans expired in June 2010; therefore, these funds were not exempt from the public service cap.

### **Conclusion**

According to 24 CFR 570.201(e)(1), the amount of CDBG funds obligated within a program year to support public service activities under this category may not exceed 15 percent of the total grant awarded to the grantee for that year.<sup>7</sup> Contrary to regulations, the City exceeded the 15 percent public service cap for program years 35 and 36. We attribute this condition to the City's misclassification of housing counseling costs and a lack of an approved Neighborhood Revitalization

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<sup>7</sup> Plus 15 percent of the total program income it received in the preceding program year

Strategy Area plan, which when added to the amounts already expended for public services,<sup>8</sup> caused the City to exceed the public service cap. As a result, the City exceeded its 15 percent public service cap by \$298,303. These funds were ineligible and need to be repaid to HUD.

	Program year 35	Program year 36	Totals
CDBG allocation	\$4,671,840	\$4,947,036	
Program income <sup>9</sup>	<u>\$16,239</u>	<u>\$15,347</u>	
Total allocation and program income	<u>\$4,688,079</u>	<u>\$4,962,383</u>	
Amount expended for public service activities (before reclassification)	<u>\$617,458</u>	<u>\$661,441</u>	
Reclassified housing counseling	<u>\$200,986</u>	<u>\$210,986</u>	\$411,972
Reclassified Neighborhood Revitalization Strategy Area plan	<u>N/A</u>	<u>\$55,000</u>	<u>\$55,000</u>
Amount expended for public service activities (after reclassification)	<u>(\$818,444)</u>	<u>(\$927,427)</u>	<u>(\$1,745,871)</u>
15 percent of total allocation and program income	<u>\$703,211</u>	<u>\$744,357</u>	<u>\$1,447,568</u>
<b>Amount over 15 percent cap</b>	<b><u>\$115,233</u></b>	<b><u>\$183,070</u></b>	<b><u>\$298,303</u></b>

## Recommendations

We recommend that the Director of the HUD Boston Office of Community Planning and Development instruct the City to

- 2A. Repay HUD \$298,303 that was expended in excess of the CDBG public service cap limit.
- 2B. Strengthen the its internal controls to ensure that the City properly classifies all of its activities so that it does not exceed the CDBG public service cap in future program years.
- 2C. Submit a Neighborhood Revitalization Strategy Area plan to HUD for approval.

<sup>8</sup> Before the reclassification, the percentage was under 15 percent, and, therefore, some of the reclassified cost was considered eligible, and only the amounts exceeding 15 percent were considered ineligible.

<sup>9</sup> Received from the previous program year

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### Finding 3: The City Did Not Ensure That Its Subcontracted Revolving Loan Fund Was Administered in Accordance With HUD Regulations

The City did not ensure that its subcontracted CDBG revolving loan fund was administered effectively and efficiently and in accordance with HUD regulations. Specifically, City officials did not ensure that the City's subcontracted CDBG revolving loan fund was properly set up and administered; program income was tracked, recorded, and put back into the loan fund as required; they conducted monitoring reviews of the loan program to ensure that it met a national objective; and interest earned on the loan funds was remitted to HUD for transmittal to the U.S. Treasury at least annually.<sup>10</sup> This condition occurred because officials did not properly set up the revolving loan fund contract with the subrecipient to document what types of loans would be provided; the terms of the loans; and how to track, record, and use program income. Additionally, officials did not properly monitor or oversee the subrecipient administering the revolving loan fund. Consequently, they could not document that low- and moderate-income individuals were assisted and that the loan fund of \$635,000 was used efficiently and effectively.

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#### **Revolving Loan Fund Not Properly Set Up and Administered**

The City contracted with Worcester Community Housing Resources to administer its revolving loan fund program; however, the agreement did not detail the types of loans to be made, the terms of the loans, or how to track and account for program income earned. The City provided \$400,000 in CDBG funds and \$235,000 in CDBG-Recovery Act (CDBG-R) funds to Worcester Community Housing Resources to set up the revolving loan fund. However, agency officials did not provide reports or documentation on any of the loans made or repayments received. The City also did not properly monitor the revolving fund to ensure that it ran properly. During our audit, officials requested a list of the loans made; however, the information received was not sufficiently detailed to determine which loans were made, the amount of the loan disbursed, or the amount of the loan that had been paid back.

Further, Worcester Community Housing Resources did not provide support showing that the loans were eligible. According to the City, several of the loans were deferred and forgivable, which may not have been eligible under CDBG regulations. Agency officials informed the City that several of the loans had been

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<sup>10</sup> This deficiency was identified by the HUD Boston Office of Community Planning and Development during its monitoring review performed in June 2012 and communicated to the City in August 2012 in a monitoring letter. HUD requested that the City obtain the interest within 30 days and return it to HUD; however, as of May 2013, the City had remitted no interest to HUD.

made with the agency's own funds so the agency planned to reimburse itself for these loans with CDBG funds. Therefore, these loans were not originally identified on the agency's submission of loans made. Some of these loans were made years ago and may not have had the proper CDBG restrictions in place. Further City officials told agency officials to stop lending CDBG funds as of December 2012 so that the City could determine which loans were outstanding and how much in program income had been received.

### **Program Income Not Properly Tracked, Recorded, and Put Back Into Loan Fund**

The City did not obtain documentation to show how much program income had been earned. Therefore, it did not know how much interest had been repaid and whether the program income earned was properly accounted for and used in accordance with CDBG regulations at 24 CFR 570.504.

### **No Monitoring or Oversight of the Revolving Loan Fund**

Worcester Community Housing Resources did not provide beneficiary data for the loans made to the City to determine whether they were eligible under the CDBG program. Therefore, the City needs to obtain the loan files for all of the loans made with CDBG funds to ensure that the loans were made to and benefited low- and moderate-income individuals. It should be noted that the City had not monitored the revolving loan fund to ensure its compliance with CDBG and CDBG-R regulations since it was established in program year 34.

### **Interest Not Remitted to HUD as Required**

Worcester Community Housing Resources officials maintained the CDBG revolving loan funds in an interest-bearing account, but officials had not been instructed to remit interest earned on the account to HUD. Regulations at 24 CFR 570.500(b) require that funds in a revolving loan fund be held in an interest-bearing bank account and that the interest earned be transmitted to HUD at least annually; however, City officials did not submit evidence that interest was remitted to HUD. This condition occurred because the City did not put the program requirements related to remitting the interest earned to HUD at least once a year into the subgrantee agreement under which the funds were provided to the agency. As a result, none of the bank interest had been remitted to HUD since the fund was established in program year 34, although some interest was repaid to the City in program year 38.

## Conclusion

The City had no assurance that its revolving loan fund was used in accordance with HUD requirements and that the program income earned from the loans was properly tracked, recorded, and used in accordance with CDBG regulations. We attribute this condition to City officials not properly setting up the revolving loan fund contract to document what types of loans would be provided; the terms of the loans; and how to track, record, and use program income. The City also did not properly monitor the subrecipient administering the revolving loan fund. Therefore, we questioned the entire \$635,000 provided to Worcester Community Housing Resources as unsupported costs. Further, the City had not remitted interest earned on the funds to HUD as required.

## Recommendations

We recommend that the Director of the HUD Boston Office of Community Planning and Development instruct the City to

- 3A. Provide documentation to support that \$635,000 in CDBG program funds was used in accordance with HUD requirements for eligible loans that met a national objective. If such support cannot be provided, the City should repay the amount.
- 3B. Determine the amount of CDBG program income earned and provide documents to ensure that it was used in accordance with HUD requirements. If such support cannot be provided, the City should repay the income to the CDBG program.
- 3C. Remit any bank interest earned on the revolving loan fund to HUD for transmittal to the U.S. Treasury.
- 3D. Request that Worcester Community Housing Resources repay any funds available in the revolving loan fund and restructure the revolving loan fund agreement to ensure that future loans are CDBG eligible and processed in accordance with HUD CDBG regulations.
- 3E. Establish and implement a program income policy and include the policy in all of the subrecipient agreements to ensure that program income is tracked, recorded, and used in accordance with HUD CDBG regulations.
- 3F. Establish and implement a monitoring policy to ensure that all loans are CDBG eligible and meet a national objective.

## SCOPE AND METHODOLOGY

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The audit focused on whether the City established and implemented adequate controls to ensure that the CDBG program was administered in accordance with program requirements. We performed the audit fieldwork from October 2012 to May 2013 at the Worcester City Hall located at 455 Main Street, Worcester, MA. Our audit covered the period July 2009 through September 2012 and was extended when necessary to meet our audit objectives.

To accomplish our objectives, we

- Reviewed relevant CDBG program requirements and applicable Federal regulations to gain an understanding of CDBG administration requirements.
- Interviewed staff from the HUD Boston, MA, Office of Community Planning and Development and the City's Executive Office of Economic Development.
- Reviewed the City's consolidated annual performance and evaluation reports, action plans, and city council minutes related to CDBG activity to gather data on the City's expenditures.
- Reviewed the City's audited financial statements for fiscal years ending June 30, 2010, 2011, and 2012, to further understand the City's programs and identify issues for follow-up.
- Reviewed HUD's IDIS reports to document the City's activities and disbursements. Our assessment of the reliability of the data in this system was limited to data reviewed and reconciled with City records; therefore we did not assess the reliability of this system.
- Selected a nonstatistical sample of 11 CDBG activities with an authorized amount of more than \$5.7 million to test for compliance with HUD regulations. This amount represented 41 percent of \$13.9<sup>11</sup> million received by the City and used to fund 71 activities during program years 35, 36, and 37. These activities were selected based on risk identified by the HUD Boston Office of Community Planning and Development and our interviews with City staff.
- Identified all of the City's public service activities and calculated the percentage of CDBG funds used for public service activities.
- Reviewed the CDBG revolving loan fund of \$635,000<sup>12</sup> for compliance with HUD regulations.

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<sup>11</sup> This amount includes unexpended balances from previous years CDBG funds that were allocated to projects in program years 35, 36 and 37.

<sup>12</sup> The revolving loan fund was set up with \$400,000 in CDBG funds and \$235,000 in CDBG-R funds.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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### Relevant Internal Controls

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

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

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiencies

Based on our review, we believe that the following items were significant deficiencies in program years 35, 36, and 37:

- The City did not have adequate controls over efficiency and effectiveness of program operations when officials did not establish adequate administrative controls to ensure that costs associated with affordable housing, public service, and code enforcement activities were adequately classified, eligible, and supported (see findings 1, 2, and 3).
- The City did not have adequate controls over reliability of financial data when officials did not establish adequate financial controls to ensure that the agencies reimbursed or funded with CDBG funds provided valid and reliable data based on the activities performed (see findings 1, 2, and 3).
- The City did not have adequate controls over compliance with laws and regulations when officials did not always comply with HUD regulations while disbursing program funds, classifying activities, and ensuring that activities met a national objective (see findings 1, 2, and 3).
- The City did not have an adequate system to ensure that resources were properly safeguarded when officials did not obtain adequate documentation to ensure that costs charged to their affordable housing, public service, code enforcement, and revolving fund activities were eligible and supported (see findings 1, 2, and 3).

## APPENDICES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

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Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	\$2,111,011		
1B		\$3,292,630	
1C			\$153,268
2A	\$298,303		
3A		\$635,000	
	<u>\$2,409,314</u>	<u>\$3,927,630</u>	<u>\$153,268</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the City implements our recommendations to reprogram \$153,268 in unspent allocated affordable housing and Operation Clean City activities, they can assure HUD that these funds will be properly put to better use.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

#### City of Worcester, Massachusetts

Michael V. O'Brien  
City Manager

Timothy J. McGourthy  
Chief Development Officer  
Executive Office of Economic Development



June 25, 2013

Edgar Moore  
Regional Inspector General for Audit, Boston Region 1, IAGA  
Office of Inspector General  
U.S. Department of Housing and Urban Development  
10 Causeway Street, Room 370  
Boston, MA 02222-1092

Dear Mr. Moore:

Thank you for the opportunity to comment on the audit team's draft report "City of Worcester, MA Community Development Block Grant Program." For more than two years, the City has taken numerous steps to improve the management of our Federal entitlement programs. Following the City's thorough internal review and analysis of our Federal programs in 2011, we recognized that the existing funding and monitoring practices were not acceptable. We began to restructure our grant management programs to put comprehensive and transparent processes in place to meet national objectives and ensure proper oversight and administration. We have done so with an open and competitive request for proposals structure, a comprehensive public review process in partnership with our citizen advisory committee, and rigorous compliance procedures to ensure that all contracts and all payments meet Federal standards.

Although these improved procedures have addressed Fiscal Year 2013 and beyond, we continue to work with the U.S. Department of Housing and Urban Development (HUD), including your office, to conclude a review of past-year contracts in Years 35, 36, and 37 (equivalent to City Fiscal Years 10, 11, and 12). We acknowledge that there were issues in the City's past contracts and monitoring processes that allowed payment for ineligible outcomes. Based on our own review and your audit, it is clear that the City should have scoped projects to require subrecipients to produce more specific outcomes, monitored progress toward completion of those outcomes, and paid only for eligible accomplishments. HUD contracted with the City to oversee these dollars in compliance with all HUD regulations and the City did not ensure full compliance in all cases.

While the draft audit highlights issues of the past, I do want to highlight current and future improvements. We have taken significant steps to ensure that the City's Federal programs serve as positive models going forward. Over the last two years, we have:

- Cooperated and coordinated with HUD and Dennison & Associates, a HUD-provided technical assistance consultant, to review past practice and draft written management plans and policies to ensure ongoing compliance with Community Development Block Grant (CDBG) regulations.

### Comment 1

**Ref to OIG Evaluation**

**Auditee Comments**

- Identified new contracts and scoping language for Year 38 (current year) proposals that incorporate HUD-approved, eligible performance measures.
- Established a strengthened dual monitoring process, incorporating checks and balances, between the Executive Office of Economic Development and Budget Office to ensure greater internal control via a layered review of proposed project expenditures.
- Established a new position of Compliance Manager within the Executive Office of Economic Development to standardize contracts and processes across various funding sources and provide internal audits on all program activities and expenditures.
- Strengthened our annual community needs assessment based on data and public input to define priorities that inform the CDBG request for proposal process.
- Enhanced the role of our community advisory body in the review and recommendation of funding proposals.
- Reviewed program income and unexpended balances in order to reprogram for future eligible activity.
- Restructured division operations and transitioned staff.

We have fully adapted to HUD’s specific focus on national objectives, and, while that has made for significant changes in external funding expectations and a difficult transition after decades of limited change, we are confident that we have built a strong framework for all Federal funding programs moving forward.

With that stated, we do have certain questions and comments related to the draft audit report and believe that some of the initial calculations outlined within the report may not be complete. We offer our comments below on each proposed finding.

Finding 1: The City’s CDBG Activities Were Not Always Eligible and Supported and Did Not Always Meet a National Objective

We acknowledge that City contracts have not differentiated well between subrecipients and development entities over the years. We sought to support neighborhood revitalization activities in housing development, financing, and code enforcement without clear scoping of outcomes necessary for CDBG eligibility determinations. In conjunction with your review, we too have gone over prior year contracts to confirm outcomes and we have redesigned our contract scopes to ensure current and future clarity. We have reached a number of conclusions, however, that differ with your determinations that we would respectfully ask that you consider.

**Comment 2**

- In calculating eligibility, the audit held all funded development projects to a developer fee and overhead cost reasonableness standard of 20% of the total hard costs and soft costs of the project. The City’s previous discussions with HUD staff and experience with development project financing establishes that a cost reasonableness standard for developer fee and overhead would be 20% of the total development costs, which is hard costs, soft costs, and acquisition. The rationale for removal of acquisition costs from this equation is not clear and substantially increases the amount of ineligible project costs subject to repayment. We would respectfully ask that, in the case of Years 35, 36, and 37, the 20% developer fee and overhead calculation be based on the total development cost of the project, which includes acquisition.

**Comment 3**

- In calculating eligibility, the audit allowed Worcester Community Housing Resources (WCHR) a total fee and overhead in the loan and receivership programs of 20% on total loan amount or cost of improvement respectively. While we appreciate the approach to reasonable fee and overhead, we would posit that certain additional delivery costs involved in a loan program or receivership program should be considered direct costs and therefore eligible. The 20% figure correlates to

**Comment 4**

that allowed on development projects. However, on development projects the developer does not pay for the associated soft costs (such as architectural services and inspections) out of the fee and overhead; those costs are accounted for and paid directly as project delivery costs. In the private credit market, these fees would be charged directly to the person seeking credit. The WCHR loan program provides credit to low- and moderate-income clients who do not qualify for traditional credit; it would be unreasonable and infeasible to expect these clients to pay for those services without support. Similarly, it would be unreasonable and infeasible to expect WCHR to manage this program while also paying all costs associated with delivering this service out of the fee and overhead earned. We believe that the following costs should be considered direct costs and not fee or overhead: processing fees; origination fees; closing fees; and, legal fees. In addition, the program relies on the work of a rehabilitation specialist to prepare scopes of work and perform inspections. This work is administrative but also a direct and necessary cost of program delivery and therefore should be considered reimbursable to a reasonable amount to be identified in ongoing conversations between the City and HUD.

- The audit determined that the City's public service contracts were "unsupported." This is due to the fact that the City has traditionally relied on subrecipients to maintain required documentation on site, so that the documentation was not available for review by the audit team. As a result of the City's own internal review, starting in Year 38 the City implemented more robust documentation requirements for all project cash requests submitted by public service entities. We now require a copy of all eligibility documentation for our files as well as the subrecipient's files. We are confident that the City's public service contracts provide much needed social services and social safety net programs that benefit low- and moderate-income areas and clientele and that the large majority will meet HUD eligibility requirements upon review of all documentation. We are actively working with local subrecipients to compile requested prior-year documentation to illustrate accomplishment of HUD national objectives.
- As referenced above, the City established a more rigorous monitoring program in Year 38. With the appointment of a Compliance Officer in the Executive Office of Economic Development and a Compliance Manager in the Budget Office, we now boast a strengthened dual monitoring process, incorporating checks and balances, to ensure greater internal control via a layered review of proposed project expenditures. We have also formalized an on-site monitoring process of all Federal fund contracts. As we enter Year 39, we will implement a fall and spring onsite monitoring program to ensure that every program is reviewed, analyzed, and, in case of findings, corrected.
- Operation Clean City began many years ago as an expansion of City management and maintenance of public properties in distressed areas. At the time, the CDBG funding allowed the City to engage in enhanced activity to address dumping and debris as well as remove unsightly overgrowth. Operation Clean City has improved Worcester's neighborhoods and created a safer and more accessible environment for our residents. In its origins, it was a clear "quantifiable increase in the level of an existing service." We recognize, however, that Operation Clean City has, over time, become a standard (albeit a higher standard) operating program of general local government. While we firmly believe that the program and therefore the funding secured the national objective of addressing blight, we accept that the audit, as a result of the ongoing nature of the program, views this activity as one of the regular responsibilities of the City.
- The City recognizes that some CDBG-funded Code Inspection activity during Years 35, 36, and 37 did not comply with all eligibility standards. We also agree that constable services were not contracted activities in Years 35 and 36. The audit highlighted a significant portion of past Code Inspection funding as "unsupported." During the years in question, the Department of Inspectional Services undertook proactive, City-driven reviews of CDBG-eligible areas and properties. We will provide appropriate documentation to illustrate the accomplishment of HUD-related national objectives. We will also continue to work with HUD New England Region to

**Comment 5**

identify and implement any necessary corrective actions. For example, in Year 38, the Executive Office of Economic Development has been working with the Department of Inspectional Services and HUD New England Region to address and respond to the following items to ensure that CDBG-funded code inspection activities remain targeted to communities in need:

- o The definition of "deterioration" for purposes of the contract.
- o Specific boundaries of the areas to be considered eligible for CDBG-funded code inspections.
- o A sufficient description of the conditions in each area to support a determination that the area qualifies as deteriorating or deteriorated under the City's definition.
- o A strategy for using code enforcement together with other activities to arrest the decline in each area.
- o Other information as may be necessary to determine the impact that the code enforcement and other activities are having on the decline of the area during the time the CDBG-assisted code enforcement is being carried out.
- o Establishment of a draft Program Income Plan incorporating controls over identifying, reporting, and classifying CDBG program income.

Finding 2: The City Exceeded Its 15 Percent Public Service Cap

We accept that with the expiration of Worcester's Neighborhood Revitalization Strategy Areas in June 2010, certain activities assumed eligible require reconsideration. While we agree with the need to review prior year public service activities to ensure they do not exceed the 15% public service cap, we believe that some of the identified ineligible costs may prove eligible upon further review.

- The draft audit identified \$411,972 in housing counseling costs as improperly classified and determined that these activities should have been classified as "housing services." Since housing services are subject to the public service cap, these activities would put the City of Worcester over the 15% public service cap in Years 35 and 36. Instead of reclassifying these activities, we believe that this \$411,972 should be considered as currently unsupported. Much of the housing counseling activity was in support of the City's HOME program, and thus, with proper documentation, would not be subject to the public service cap. Organizations conducting housing counseling, in many cases, were counseling clients to purchase HOME assisted units, and/or were counseling clients to receive down payment assistance financed by the HOME program. While at this point we are unable to determine the exact amount of counseling done in connection with the HOME program, we believe that the \$411,972 should be viewed as unsupported and that we may substantially lower the amount that is presently considered ineligible by connecting that activity to related HOME initiatives.

Finding 3: The City Did Not Ensure That Its Revolving Loan Fund Was Administered in Accordance With HUD Regulations

**Comment 6**

- The City recognizes that the CDBG-funded revolving loan fund initiated in Year 34 for WCHR did not meet a number of eligibility standards. We concur with the recommendations outlined within the audit and will continue to work with HUD on identifying and implementing necessary corrective actions. During Year 38, the City placed a hold on the program in order to assess past expenditures and establish a framework for a compliant program that addresses national objectives, provides clear outcomes, ensures cost reasonableness, establishes monitoring processes, and accommodates program income. The City is currently reviewing programmatic policies and procedures with Dennison & Associates.
- WCHR did provide the City a simple accounting of program income/interest. The City did not forward payment to HUD as we worked to address the concerns outlined within Finding #5 of the

## Ref to OIG Evaluation

## Auditee Comments

### Comment 7

August 6, 2012 monitoring letter. The City has since forwarded that payment to HUD. We anticipate continuing our efforts to review each loan and confirm whether any additional program income or simple interest should be repaid. The City has drafted a Program Income Plan establishing controls over identifying, reporting, and classifying CDBG program income.

- The City is working with HUD New England Region with respect to additional technical assistance to effectively identify, report, and classify program data in the Integrated Disbursement and Information System (IDIS).

#### Other Corrective Actions Completed or Underway:

As referenced above, the City has been restructuring its Federal grant programs working closely with HUD New England Region and Dennison & Associates, a HUD-provided technical assistance consultant. We have made significant changes to our organizational structure, our staffing resources, our scopes and contracts, and our policies and procedures. Among many modifications:

- Hosted six (6) Neighborhood/Community Needs meetings throughout the City's neighborhoods to lay a foundation for Year 39 Federal funding priorities.
- Hosted a number of technical assistance and subrecipient education events including:
  1. Presentation/Q&A on CDBG and eligibility requirements.
  2. Technical assistance event/Q&A specific to the new CDBG Application/RFP.
  3. Electronic mail Q&A opportunity with staff as a follow-up to the technical assistance event (email responses were provided to all attendees to ensure consistent guidance).

New technical assistance events are planned for the upcoming program year including an overview of reporting requirements for all subrecipients.

- Drafted and implemented a new, targeted CDBG Application/RFP for Program Year 39.
- Strengthened staff training efforts and continued attendance at HUD-hosted workshops, trainings, and conferences to ensure staff remain current with all CDBG program requirements. The City has also put in a formal request to continue working with HUD on specific CDBG technical assistance, which will help strengthen the program and further improve on the positive changes underway.
- Enhanced the role of the Community Development Advisory Committee (CDAC) during the subrecipient allocation process for Year 39:
  1. CDAC and staff-led presentations on the CDBG and Federal funding processes.
  2. Mandatory program presentations by all potential subrecipients to the CDAC as part of the application process.
  3. Independent review and ranking of all proposals by individual CDAC members.
  4. Five (5) open/public CDAC meetings to review and discuss proposals.
  5. Composite scoring for all applications by CDAC and staff.
- Worked with HUD New England Region to improve subrecipient agreements and provide significantly more detailed scopes to ensure program outcomes and clear performance measurement benchmarks.
- In an effort to ensure projects are cost reasonable, we have drafted written policies and procedures for CDBG-supported housing including standards on developer's fee and overhead, program income plans, and subsidy layering reviews. Moving forward, the City is adopting the Massachusetts Department of Housing & Community Development (DHCD) funding model for affordable housing development projects. Developers will be reimbursed for developer fee and overhead at no more than 5% of the total acquisition costs and at no more than 12.5% of hard and soft costs. In the case of tax credit projects, a descending scale for developer fee and overhead will be used based upon the total development costs of the project: 5% of the total acquisition

### Comment 8

cost; 15% of the first \$3 million of total development hard and soft costs; 12.5% of project costs between \$3 million and \$5 million; and, 10% of project costs above \$5 million.

- Significantly upgraded the project reimbursement process. The new process stresses accountability and substantiation of all funding requests. All Project Cash Requests (PCRs) must follow the newly established process:
  1. Project Monitor works with subrecipient to gather all back-up documentation required to substantiate the funding request and activity. New activity-specific coversheet checklists have been implemented to ensure all relevant and required data is included in the PCR.
  2. Project Monitor submits PCRs to Division Director for second review and programmatic approval.
  3. Division Director submits PCRs to Economic Development Compliance Officer for third review focused on programmatic eligibility and supporting documentation.
  4. Economic Development Compliance Officer submits to Budget Compliance Manager for fourth review to ensure financial eligibility and supporting documentation.
  5. Budget Compliance Manager submits to Grants Manager for payment.
- Worked diligently to improve compliance both within the City and with all sub-recipients. All existing sub-recipients have been educated with regard to proper back-up and reporting documentation. This process will recur each year during mandatory Pre-Contract Meetings with each sub-recipient. That information includes the following:
  1. Income eligibility documentation.
  2. Client logs to show activity.
  3. Time & effort logs for any subrecipients using CDBG to pay for staff salaries.
  4. Receipts to justify funding requests.
- Dramatically upgraded monitoring processes for all CDBG funded programs and agencies. The new process includes:
  1. A formal on-site monitoring visit; a new, more detailed monitoring check-list to ensure compliance (a separate, but also new, form will be used for Continuum of Care subrecipients)
  2. A financial monitoring component as well as the traditionally programmatic monitoring
  3. A formal letter to the subrecipient following the monitoring visit addressing issues, concerns, and potential findings with an outline of all corrective actions that must be taken and deadlines for satisfying the City's concerns. If not addressed by the date provided, future PCRs will not be accepted.All grant programs requiring on-site monitoring will follow the same format.
- Initiated a new certification system for Community Housing Development Organizations (CHODOs) and Community Based Development Organizations (CBDOs).
- Created a Neighborhood Stabilization Opportunity Fund as part of Year 39 programs to ensure that, as findings are cleared and worthy eligible projects proposed, key neighborhood revitalization efforts in CDBG-eligible areas may be funded during Year 39.
- Expects new community-based planning efforts in the near future and reestablishment, as appropriate, of designated Neighborhood Revitalization Strategy Areas (NRSAs).

While, per your directive, we did not share copies of the draft audit, with your permission we did share with the individual impacted community development corporations (CDCs) the audit team's spreadsheets that made up the basis for the various determinations related to eligibility and financial exposure. At our request, four of the five impacted CDCs provided individual comment on these determinations. I attach each of those responses for your review and additional consideration. While we do not endorse all points raised by the various organizations, we believe that each agency deserved an opportunity to put forth its own independent case on the eligibility of its activities. We look forward to continuing to work with HUD

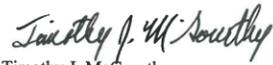
**Ref to OIG Evaluation**

**Auditee Comments**

New England Region and your team to address outstanding documentation requirements and provide appropriate support.

Once again, we appreciate the opportunity to review this draft audit and provide comment. While we acknowledge the issues of the past, we believe we have crafted a strong foundation for the future. We look forward to your comment on the concerns raised above and we look forward to working with HUD New England Region to lay out a plan to ensure that the City of Worcester moves forward cooperatively in our joint efforts to serve Worcester's neediest communities and fulfill HUD's national goals and objectives.

Sincerely,



Timothy J. McGourthy  
Chief Development Officer

Attachments

### **OIG Evaluation of Auditee Comments**

- Comment 1** City officials acknowledged that in the past they should have required subrecipients to produce more specific outcomes, monitor progress, and paid for only eligible accomplishments. As such, they contend that they are now working with HUD and its technical assistant to improve the CDBG program to ensure future compliance with CDBG regulations; therefore, we acknowledged this effort in the background section of this report.
- Comment 2** City officials believe that OIG's estimated computation of ineligible cost using a 20 percent developer fee on total hard and soft cost only increases the ineligible amount; as such they believe that we should have included acquisition costs in the computation of ineligible developer fees. They also indicated on page 5 of the written response (comment 8) that they drafted written policies and procedures for CDBG-supported housing including standards on developer's fee and overhead and that moving forward, the City is adopting the Massachusetts Department of Housing and Community Development funding model for affordable housing development projects whereby developers will be reimbursed at no more than 5 percent of the total acquisition costs and at no more than 12.5 percent of hard and soft costs. With this in mind, we agreed to include 5 percent of the total acquisition costs and 12.5 percent of hard and soft costs, consistent with the new proposed fee schedule, and have revised the estimated computation of ineligible cost accordingly. We believe that our estimated computation is reasonable however; this issue will have to be resolved during the audit resolution process with HUD.
- Comment 3** City officials believe that OIG's estimates of total fees and overhead should have considered certain administrative costs such as processing, origination, closing and legal fees as direct fees. However, the City did not have a fee schedule for these services and no basis for the reasonableness of the costs charged. For example in some instances, the administrative costs charged to the CDBG program greatly exceeded the amount of the assistance provided to the homeowner. Again since we believe we used a reasonable method to calculate the maximum allowable administrative expense to charge to the CDBG program; City officials should work with HUD during the audit resolution process to develop a fee schedule, which includes reasonable and eligible fees allowable for the services provided by Worcester Community Housing Resources in the future.
- Comment 4** City officials acknowledged that they did not obtain the required documentation at their office to ensure that public service activities were meeting a national objective; that monitoring was not adequate; that operation clean city became a standard general local government program; and that code inspection activities were not always eligible. However, they state that during program years 38 and 39 they increased documentation requirements, monitoring, etc., to ensure that

they will be able to document CDBG eligibility in the future. These are all actions that are responsive to our recommendations.

- Comment 5** City officials believe that some of their housing counseling activities may be eligible as housing services. However, the City was given substantial time during the audit to document that its housing counseling activities were eligible housing services; but, they were not able to obtain and provide the information from its subrecipients. The City also informed OIG that only a small portion of the housing counseling activities were related to HOME assisted units and would not substantially change the reclassified amount. As such, we still consider all of the housing counseling costs as public service activities, which caused the City to exceed the 15 percent public service cap. Nevertheless, if the City is able to provide additional documentation to support that housing counseling activities were housing services, this would have to be resolved during the audit resolution process with HUD.
- Comment 6** City officials acknowledge that their revolving loan fund did not meet all eligibility standards and that simple interest from the interest bearing account was not immediately remitted to HUD as required. They state that they are working with HUD to implement needed changes and have since remitted the simple interest to HUD. However, since we did not review this, these changes and subsequent remittance of interest will have to be confirmed and resolved during the audit resolution process with HUD.
- Comment 7** OIG acknowledges that all corrective actions started in program year 38 to correct the issues identified in the past program years are responsive to our recommendations.
- Comment 8** City officials have stated that they laid out various actions to correct their procedures going forward, all of which are responsive to our recommendations.

## Appendix C

### SCHEDULE OF QUESTIONED AFFORDABLE HOUSING, PUBLIC SERVICE, AND CODE INSPECTION COSTS BY AGENCY AND ACTIVITY (FINDING 1)

Agency	Ineligible	Unsupported	Funds to be put to better use	Total questioned costs by agency
Worcester East Side CDC	\$407,407	\$25,425	\$17,168	\$450,000
Worcester Common Ground CDC	\$367,265	\$156,811	\$15,924	\$540,000
Oak Hill CDC	\$255,372	\$189,191	\$21,328	\$465,891
Main South CDC	\$294,539	\$245,461	\$0	\$540,000
South Worcester Neighborhood Center <sup>13</sup>	\$0	\$35,556	\$0	\$35,556
<b><i>Subtotal affordable housing</i></b>	<b><i>\$1,324,583</i></b>	<b><i>\$652,444</i></b>	<b><i>\$54,420</i></b>	<b><i>\$2,031,447</i></b>
Worcester Community Housing Resources (CDFI*)	\$575,356	\$216,695	\$62,699	\$854,750
<b>Total affordable housing</b>	<b>\$1,899,939</b>	<b>\$869,139</b>	<b>\$117,119</b>	<b>\$2,886,197</b>
Friendly House	\$0	\$515,768	\$0	\$515,768
Henry Lee Willis	\$0	\$346,429	\$0	\$346,429
Cento Las Americas	\$0	\$205,965	\$0	\$205,965
South Worcester Neighborhood Center	\$0	\$441,481	\$0	\$441,481
Operation Clean City	\$130,512	\$0	\$36,149	\$166,661
<b>Total public services</b>	<b>\$130,512</b>	<b>\$1,509,643</b>	<b>\$36,149</b>	<b>\$1,676,304</b>
Code inspection	\$80,560	913,848	\$0	\$994,408
<b>Total code inspection</b>	<b>\$80,560</b>	<b>\$913,848</b>	<b>\$0</b>	<b>\$994,408</b>
<b>Grand total</b>	<b>\$2,111,011</b>	<b>\$3,292,630</b>	<b>\$153,268</b>	<b>\$5,556,909</b>

\* CDFI = community development financial institution

<sup>13</sup> The South Worcester Neighborhood Center is not a community development corporation; it is a public service agency. The agency was funded for a rehabilitation specialist position in program year 37. This position was originally funded under Oak Hill CDC for program years 35 and 36. This amount is considered unsupported for all three years (35, 36, and 37) as no documentation was provided to show what work was performed and how a national objective was met. This is the only CDBG affordable housing funding the South Worcester Neighborhood Center received.

## Appendix D

# APPLICABLE HUD AND CITY OF WORCESTER CONTRACT REQUIREMENTS

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### HUD Regulations

24 CFR 85.40(a), **Monitoring by grantees.** 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. Grantee monitoring must cover each program, function or activity.

24 CFR 201(n), **Homeownership assistance.** CDBG funds may be used to provide direct homeownership assistance to low- or moderate-income households in accordance with section 105(a) of the Act.

24 CFR 202(c), **Code enforcement.** Costs incurred for inspection for code violations and enforcement of codes (e.g., salaries and related expenses of code enforcement inspectors and legal proceedings, but not including the cost of correcting the violations) in deteriorating or deteriorated areas when such enforcement together with public or private improvements, rehabilitation, or services to be provided may be expected to arrest the decline of the area.

24 CFR 570.207(a)(2), **General government expenses.** Except as otherwise specifically authorized in Subpart C of Part 570 or under OMB [Office of Management and Budget] Circular A-87, expenses required to carry out the regular responsibilities of the unit of general local government are not eligible for assistance under this part.

### 24 CFR 570.503, **Agreements with Subrecipients**

(a) Before disbursing any CDBG funds to a subrecipient, the recipient shall sign a written agreement with the subrecipient. The agreement shall remain in effect during any period that the subrecipient has control over CDBG funds, including program income.

(b) At a minimum, the written agreement with the subrecipient shall include provisions concerning the following items:

(1) *Statement of work.* The agreement shall include a description of the work to be performed, a schedule for completing the work, and a budget. These items shall be in sufficient detail to provide a sound basis for the recipient effectively to monitor performance under the agreement.

(2) *Records and reports.* The recipient shall specify in the agreement the particular records the subrecipient must maintain and the particular reports the subrecipient must submit in order to assist the recipient in meeting its recordkeeping and reporting requirements.

24 CFR 570.506, ***Records to be Maintained.*** 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 one of the criteria set forth in § 570.208, ***Criteria for National Objectives.***

(h) Financial records, in accordance with the applicable requirements listed in § 570.502, including source documentation for entities not subject to parts 84 and 85 of this title. Grantees shall maintain evidence to support how the CDBG funds provided to such entities are expended. Such documentation must include, to the extent applicable, invoices, schedules containing comparisons of budgeted amounts and actual expenditures, construction progress schedules signed by appropriate parties (e.g., general contractor and/or a project architect), and/or other documentation appropriate to the nature of the activity.

### **City of Worcester Contract Requirements**

#### Section 1. Scope of Work

- 1.1. The Contractor shall perform and render the services hereinafter set forth in the terms and conditions of this Agreement and more specifically in the Scope of Work, Exhibit A, attached hereto and incorporated by reference.
- 1.2. The Contractor is and shall at all times remain an “independent contractor” with respect to the services to be performed under this Agreement.
- 1.3. The Contractor shall comply with the requirements of Title 24 of the Code of Federal Regulations, Part 570 (HUD regulations concerning Community Development Block Grants (hereinafter “CDBG”)) including subpart K of these regulations, except that, to the extent required by the Granting Authority, (a) the Contractor does not assume the City’s environmental responsibilities described in 24 CFR 570.604 and (b) the Contractor does not assume the City’s responsibility for initiating the review process under the provisions of 24 CFR Part 52. The Contractor shall comply with all other applicable federal, state and local laws, ordinances, regulations, orders, guidelines and policies governing this Agreement. The Contractor shall utilize funds available under this Agreement to supplement rather than supplant funds otherwise available.

- 1.4. All the Contractor's activities funded with CDGB funds shall meet one of the CDBG Program's National Objectives: benefit low- and moderate-income persons; aid in the prevention or elimination of slums or blight; or meet community development needs having a particular urgency, as defined in 24 CFR 570.208 and further set forth in 24 CFR 570.503(5).

## Section 10. Records

- 10.1.1 Without limiting the generality of the foregoing, the Contractor shall maintain records required by the federal regulations specified in 24 CFR 570.506 that are pertinent to this Agreement, including but not limited to (a) records providing a full description of each activity undertaking, (b) records demonstrating that each activity undertaken meets one of the National Objectives of the CDBG program, (c) records required to determine the eligibility of activities, (d) records required to document the acquisition, improvement, use or disposition of real property acquired or improved with CDBG assistance, (e) records documenting compliance with the fair housing and equal opportunity of the CDBG program, (f) financial records as required by 24 CFR 570.502, and 24 CFR 84.21-28, and (g) other records necessary to document compliance with Subpart K of 24 CFR Part 570.
- 10.1.2 The Contractor shall maintain client data demonstrating client eligibility for services provided. Such data shall include, but not be limited to, client name, address, income level or other basis for determining eligibility, and description of service provided. Such information shall be made available to the City, the Granting Authority and their respective designees for review upon request. Disclosure of client information collected under this agreement is prohibited, except as expressly required by this Agreement, the City, Granting Authority, or otherwise required by law.
- 10.1.3 The Contractor shall maintain separate records for funding transactions relating to this Agreement, and promptly furnish to the City any and all documents necessary to accomplish the audit of this CDBG Program as further described below.
- 10.3 The Contractor shall retain and secure for a minimum period of five (5) years all financial records, supporting documents, statistical records and all other records pertinent to the CDBG program, including but not limited to the records identified in this section. Except as may be otherwise required herein, the retention period shall begin on the date the City submits its final annual performance and evaluation report to HUD regarding the activities assisted under this Agreement. The Contractor shall retain records beyond the said five (5) year period if audit findings have not been finally resolved. Further records for non-expendable

property that were acquired with CDBG funds shall be retained for five (5) years after its final disposition. Records for any displaced parties shall be retained for five (5) years after said parties have received their final payment. Notwithstanding the above, if there is litigation, claims, audits, negotiations or other actions that involve any of the records cited and that have been started before the expiration of the five-year period, than such records shall be retained until completion of the actions and resolution of all issues, or the expiration of the five-year period, whichever occurs later.

## Section 12. Program Income and Budget Adjustments

- 12.4 Any directives, orders, or other actions by HUD to restrict, exclude, modify, demand a refund, penalize the City on finding ineligible any project or program under this Agreement because of the Contractor's failure to abide by or observe the requirements and conditions of the Affirmative Action Plan or Equal Opportunity Plan or any other Federally mandated requirement, shall be just cause for the City to demand immediately re-payment or reimbursement from the Contractor and take any other appropriate administrative or legal action.