



## **The City of Kansas City, MO**

### **Neighborhood Stabilization Program 1**



Issue Date: February 5, 2014

Audit Report Number: 2014-KC-1003

TO: Dana Buckner, Director, Office of Community Planning and Development, Kansas City, KS, 7AD

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The City of Kansas City, MO, Did Not Properly Obligate Its NSP1 Grant Funds and Allowed Its Subrecipient To Enter Into Contracts Without the Required Provisions

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the City of Kansas City, MO.

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 8M, 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 913-551-5870.



February 5, 2014

## **The City of Kansas City, MO, Did Not Properly Obligate Its NSP1 Grant Funds and Allowed Its Subrecipient To Enter Into Contracts Without the Required Provisions**

# Highlights

Audit Report 2014-KC-1003

### What We Audited and Why

We selected the City of Kansas City, MO's Neighborhood Stabilization Program 1 (NSP1) based on previous problems in the City's Community Development Block Grant (CDBG) program and the amount of funding it received. During fiscal year 2008, the City received more than \$7.3 million in NSP1 funding. Our audit objectives were to determine whether the City properly obligated its NSP1 grant funds and allowed its subrecipient to enter into contracts without the required provisions.

### What We Recommend

We recommend that HUD require the City to develop and implement a system to track its subrecipient's obligation of NSP1 funds and develop and implement detailed operational policies and procedures to ensure proper obligation of NSP1 funds. In addition, we recommend that HUD require the City to work with its subrecipient to amend its NSP1-funded contracts to include the missing provisions and adequately train its staff regarding the provisions required in NSP1-funded contracts.

### What We Found

The City improperly obligated \$63,494 of its NSP1 funds. It improperly obligated \$14,467 when it used estimated instead of actual amounts and \$49,027 when it used amounts based on contracts signed after the obligation deadline of September 19, 2010.

The City also allowed its subrecipient to enter into contracts without all of the required provisions. None of its seven contracts between the subrecipient and its primary property developers included all required provisions.

## TABLE OF CONTENTS

---

Background and Objectives	3
Results of Audit	
Finding 1: The City Improperly Obligated \$63,494 of Its NSP1 Funds	4
Finding 2: The City Allowed Its Subrecipient To Enter Into Contracts Without the Required Provisions	6
Scope and Methodology	8
Internal Controls	9
Appendixes	
A.    Auditee Comments and OIG’s Evaluation	11
B.    Criteria	14

## **BACKGROUND AND OBJECTIVES**

---

The Neighborhood Stabilization Program (NSP) was authorized under Title III of the Housing and Economic Recovery Act of 2008. It provides grants to States and certain local communities to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop them to stabilize neighborhoods and stem the declining value of neighboring homes. The Act calls for allocating funds to “states and units of local governments with the greatest need.” In the first phase of the program, NSP1, the U.S. Department of Housing and Urban Development (HUD) allocated \$3.9 billion in program funds to assist in the redevelopment of abandoned and foreclosed-upon homes.

On March 19, 2009, HUD signed an agreement with the City of Kansas City, MO, for more than \$7.3 million in NSP1 funds. The City is responsible for ensuring that the NSP1 funds are used in accordance with program requirements. On June 17, 2009, the City contracted with the Economic Development Corporation of Kansas City to administer the NSP1 funds as its subrecipient. The use of a designated subrecipient did not relieve the City of its responsibility to ensure that program funds were used in accordance with applicable requirements.

During calendar years 2009 and 2010, the Corporation contracted with seven primary property developers to acquire and rehabilitate qualified, abandoned or foreclosed-upon properties in the greater Kansas City area. The City and the Corporation are responsible for determining the adequacy of performance under subrecipient agreements as described in 24 CFR (Code of Federal Regulations) 570.910. They are also required to ensure that all contracts funded under NSP1 comply with procurement regulations at 24 CFR 84.84(h)(5), appendix A.

The Disaster Recovery Grant Reporting (DRGR) system was developed by HUD for the Disaster Recovery Block Grant program and other special appropriations. HUD uses the DRGR system to track NSP1 funding because no other application and reporting system is sufficiently flexible to deal with program requirements.

Our audit objectives were to determine whether the City properly obligated its NSP1 funds and allowed its NSP1 subrecipient to enter into contracts without the required provisions.

## RESULTS OF AUDIT

---

### Finding 1: The City Improperly Obligated \$63,494 of Its NSP1 Funds

The City improperly obligated \$63,494 of its NSP1 funds. This condition occurred because the City lacked controls to track or monitor the Corporation's obligation of NSP1 funds. As a result, the funds were not available for use by other qualified program participants.

---

#### **The City Improperly Obligated NSP1 Funds**

The City improperly obligated \$63,494 of its NSP1 funds, contrary to section 2301(c)(1) of the Housing and Economic Recovery Act, which requires grantees to use NSP funds within 18 months of receipt of the funds. Compliance with the statutory 18-month use requirement requires the grantee or subrecipient to document that an obligation linked to a specific NSP activity was incurred. NSP Policy Alert, Volume 3, April 23, 2010, states that if the grantee or subrecipient provides assistance to a developer, an obligation may be recorded when the developer's agreement is executed and the developer has identified specific properties to be acquired or rehabilitated. HUD will consider the NSP funds obligated for a specific activity only when the developer furnishes the grantee or subrecipient with information identifying specific properties and providing documented cost estimates for each activity (see appendix B).

As of September 30, 2010, the City reported more than \$7.3 million (100 percent) of its initial NSP1 funds as obligated in the DRGR system. The City generally based its obligations on information provided by the Corporation. In four instances, it improperly obligated a total of \$14,467 when the Corporation estimated the obligations, which were not fully supported by contracts, and entered into written agreements with primary property developers. In two instances, the City improperly obligated a total of \$49,027 when the Corporation obligated funds based on contracts signed after the obligation deadline of September 19, 2010. The two contracts were signed on January 6 and September 11, 2011.

#### **The City Lacked Controls Over the Obligation of NSP1 Funds**

The City lacked controls to track or monitor the Corporation's obligation of its NSP1 funds. It generally relied on information provided by the Corporation and did not require its program staff to verify the obligation information received from the Corporation. The City's program staff told us they did not review the

obligation information received from the Corporation against supporting documentation before entering the data into the DRGR system.

### **Funds Were Not Available for Program Participants**

As a result of the issues discussed above, a total of \$63,494 of the City's NSP1 funds was not available for use by other qualified program participants.

### **Recommendations**

We recommend that the Director of HUD's Kansas City, KS, Office of Community Planning and Development require the City to

- 1A. Develop and implement a system to track and monitor the Corporation's obligation of NSP1 funds to comply with section 2301(c)(1) of the Housing and Economic Recovery Act and applicable HUD rules and regulations.
- 1B. Develop and implement detailed operational policies and procedures to ensure proper obligation of NSP1 funds, including ongoing program income, in compliance with the Housing and Economic Recovery Act and applicable HUD rules and regulations.

## RESULTS OF AUDIT

---

### Finding 2: The City Allowed Its Subrecipient To Enter Into Contracts Without the Required Provisions

The City allowed the Corporation to enter into seven NSP1-funded contracts that did not contain all of the required provisions. This condition occurred because the City did not adequately train its program and Corporation staff regarding HUD contract requirements. As a result, the City and HUD lacked assurance the contractors would comply with all program requirements. In addition, they could not ensure that their own interests were fully protected.

---

#### **Required Provisions Were Not Included in NSP1 Contracts**

The City allowed its NSP1 subrecipient to enter into seven NSP1-funded contracts without all of the provisions required by Federal regulations. On June 17, 2009, the City contracted with the Corporation to administer its NSP1 grant funds. The Corporation was required to follow Community Development Block Grant (CDBG) procurement rules outlined in 24 CFR 84.84 to hire contractors for the purchase of goods and services.

During calendar years 2009 and 2010, the Corporation contracted with seven primary property developers to acquire and rehabilitate qualified, abandoned or foreclosed-upon properties in the Kansas City area. According to regulations at 24 CFR 84.84(h)(5), appendix A, all contracts, including small purchases, awarded by recipients and their contractors are required to contain certain provisions, including (1) Copeland “Anti-Kickback” Act, (2) Contract Work Hours and Safety Standards Act, (3) rights to inventions made under a contract or agreement, (4) Clean Air Act and Federal Water Pollution Control Act, (5) Byrd anti-lobbying amendment, (6) debarment and suspension, and (7) Drug-Free Workplace Act requirements (see appendix B).

None of the seven contracts between the Corporation and its primary property developers addressed any of the above required provisions. As a result of our review, the Corporation began preparing contract amendments to address the missing provisions in each of the contracts.

#### **The City Did Not Adequately Train Program Staff**

The City did not adequately train its program and the Corporation staff regarding HUD contract requirements. Its program and the Corporation staff members told



us that they had not been trained regarding the required provisions of NSP1 contracts and did not review the seven contracts for compliance with applicable regulations.

### **There Was No Assurance of Program Compliance**

The City and HUD lacked assurance that the contractors would comply with all program requirements. In addition, they could not ensure that their own interests were fully protected.

### **Recommendations**

We recommend that the Director of HUD's Kansas City, KS, Office of Community Planning and Development work with the City to require the Corporation to

- 2A. Amend its NSP1 contracts with its primary property developers to include the missing provisions.
- 2B. Adequately train its staff regarding the required provisions of NSP1-funded contracts.

## SCOPE AND METHODOLOGY

---

Our review period generally covered March 19, 2009, through March 19, 2013. We performed onsite work from August 16 through November 20, 2013, at City Hall, located at 414 East 12<sup>th</sup> Street, Kansas City, MO. We performed additional onsite work at the subrecipient's offices, located at 1100 Walnut, Suite 1700, Kansas City, MO.

To accomplish our objectives, we interviewed City and the Corporation staff and reviewed

- Applicable provisions of the Code of Federal Regulations, the Housing and Economic Recovery Act of 2008, Office of Management and Budget circulars, and various program policy alerts;
- The City's Procurement Procedures Manual;
- Relevant audit reports and the City's audited financial statements;
- The grant and subrecipient agreements, which included other contractor contracts; and
- The subrecipient's obligation and expense files.

We reviewed a sample of 14 NSP1 obligations from a universe of 63 (22 percent) completed by the City before the obligation deadline of September 19, 2010. We initially selected nine sample obligations for testing to determine whether they complied with section 2301(c)(1) of the Housing and Economic Recovery Act. The nine sample obligations included those recorded closest to the obligation deadline because they were likely to be misstated or otherwise have high risk. Because we found evidence of improper obligations, we expanded the sample to include five additional obligations recorded during the beginning and peak periods of the program. We selected the highest dollar amounts due to the likelihood of misstatements or the potential for high risk. When selecting our sample, we did not consider the organizations carrying out the activities because there were no known special circumstances in regard to them. We also did not select administrative fees for testing because the City was allowed to obligate 10 percent of the grant for administrative costs upfront. The cumulative dollar amount of the obligations tested was nearly \$1.5 million of the more than \$7.6 million (19.57 percent) in obligations.

We also reviewed seven property developer agreements and the City's procurement process used to select the developers. The seven developers were the only ones the Corporation used to acquire and rehabilitate single-family projects using NSP1 funds.

We relied on computer-processed data provided by the City and the Corporation, which was responsible for the administration of the City's NSP1. We performed sufficient tests of the data using data analysis techniques, and based on the assessments and testing, we concluded that the data were sufficiently reliable to be used in meeting our objective.

We performed our review 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

---

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.

---

## Relevant Internal Controls

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

- Controls over obligating NSP1 funds.
- Controls over developing NSP1 contracts.

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 are significant deficiencies:

- The City did not have adequate controls over obligating its NSP1 funds (see finding 1).
- The City did not have controls to ensure that its program and subrecipient contracts contained all of the required provisions (see finding 2).

## **Separate Communication of Minor Deficiencies**

We reported minor deficiencies to the auditee in a separate management memorandum

# APPENDIXES


## Appendix A

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments

#### Comments



**Neighborhood and Community Services Department**

Office of the Director

4th Floor, City Hall  
414 E. 12th Street  
Kansas City, Missouri 64106-2768

(816) 513-3200  
Fax: (816) 513-3201

January 17, 2014

Ronald J. Hosking  
Regional Inspector General for Audit  
Office of Audit Region 7  
400 State Avenue, Suite 501  
Kansas City, Kansas 66101

**Subject:** Auditee (City of Kansas City, Missouri) Comments on the Neighborhood Stabilization Program One Audit

Dear Mr. Hosking,

The City of Kansas City, Missouri received a \$7,323,734 allocation under the Neighborhood Stabilization Program One (NSP1). This funding was used to successfully purchase and rehabilitate sixty-six (66) foreclosed upon and/or abandoned single family dwellings that were eventually sold to homeowners with annual incomes not exceeding 120% of area median income. Despite having to implement a program with constantly changing regulations, the City's initial NSP-1 allocation was obligated for eligible purposes by the obligation deadline.

Staff from the U.S. Department of Housing and Urban Development - Office of Inspector General conducted an audit of the City of Kansas City, Missouri's NSP 1 during September – December 2013. Their audit resulted in two findings.

**Finding 1:** The City improperly obligated \$63,494 of its NSP1 funds.

**City's Comment:** The City disagrees with the recommended action, "1B. Recapture an estimated \$63,494 from the City's unspent NSP1 grant funds that was improperly obligated."

**Ref to OIG Evaluation**

**Auditee Comments**

Comment 1

As of the obligation deadline of September 30, 2010, the City had obligated NSP1 funds totaling \$7,646,462. In accordance with the NSP Policy Alert dated April 23, 2010, which states in pertinent part, "...at the end of the 18-month use period, each grantee's accounting records and DRGR information must reflect outlays (expenditures) and unliquidated obligations that, in the aggregate, are at least equal to the NSP allocation", the City was required to obligate \$7,323,734 by the obligation deadline. Consequently, only \$7,323,734 was reported in DRGR; the remainder of the obligated amount (\$322,668) was contained on a spreadsheet that was provided to the auditor at the time of the audit. The City's documentation proves an amount exceeding \$7,323,734 was obligated for eligible purposes by the deadline of September 30, 2010. The auditors reviewed this documentation and determined that

amount of \$63,494 was eventually spent for NSP-1 eligible costs, the City disagrees with OIG's recommendation that HUD recapture \$63,494 from the City's unspent NSP1 funds.

**Finding 2:** The City allowed its subrecipient to enter into contracts without the required provisions.

**City's Comment:** The City accepts this finding. Our subrecipient's staff has drafted a contract amendment that contains the omitted required provisions. Upon the City's approval, the contract amendments will be executed between the subrecipient and the primary property developers. Also, City staff was recently trained on the required provisions for federal contracts. City staff attended a HUD-approved contract training on October 9, 2013. The required provisions for federal contracts were covered at that time.

Thank you for allowing the City of Kansas City, Missouri to provide written comments for inclusion in the OIG's final audit report. Should you have any questions, please contact Heather Cater, Senior Analyst at (816) 513-3041 Lois Christian, Administrative Officer at (816) 513-3026.

Sincerely,



John A. Wood, Director

C: Troy Schulte, City Manager  
Joseph F. Egan, LCRA Executive Director  
Stuart Bullington, Assistant Director

## OIG Evaluation of Auditee Comments

**Comment 1** We noted that the Housing and Economic Recovery Act of 2008 authorizes the Secretary to specify alternative requirements to any provision of the Community Development Act of 1974. In part, the Secretary is required to provide Congress with written notice of waivers and publish them in the Federal Register. On October 19, 2010, HUD published a notice of NSP1 reallocation process changes in the Federal Register. This notice provides a range of corrective actions for grantees who fail to meet the 18-month requirement and recognizes that grantees will not be able to budget perfectly. It also provides guidance allowing a reasonable contingency for each project. We considered these provisions, reevaluated the draft recommendation, and based upon the circumstances involved, we changed the recommendation accordingly.

## Appendix B

### CRITERIA

---

#### **Housing and Economic Recovery Act of 2008**

Section 2301(c)(1): “In general, any state or unit of general local government that Receives amounts pursuant to this section shall, not later than 18 months after the receipt of such amounts, use such amounts to purchase and redevelop abandoned and foreclosed homes and residential properties.”

#### **NSP Policy Alert, Volume 3, April 23, 2010**

Overview: “Section 2301(c)(1) of the Housing and Economic Act of 2008 requires grantees to use NSP funds within 18 months of receipt of the funds. The NSP Notice published on October 6, 2008, provides that NSP funds are used for the purposes of section 2301(c)(1) when they are obligated by a grantee (or its subrecipient) for a specific NSP activity. Thus compliance with the statutory use requirement requires the grantee (or subrecipient) to document the following:

- an obligation was incurred, and
- the obligation can be linked to a NSP specific activity.”

Definition: “The term ‘obligation’ means the amounts of orders placed, contracts awarded, goods and services received, and similar transactions during a given period that will require payment by the grantee (or subrecipient) during the same or future period. Note that none of these actions would constitute a use for NSP purposes unless the action is related to a specific activity. Except for certain activities (which are discussed below), HUD does not consider NSP funds obligated for a specific activity unless the obligation can be linked to a specific address and/or household. The NSP Notice explicitly provides that funds are not obligated for an activity when sub awards (e.g., grants to subrecipients or to units of general local government) are made.”

#### **24 CFR 84.84**

24 CFR 84.84(h)(5): “All contracts, including small purchases, awarded by recipients and their contractors shall contain the procurement provisions of appendix A as applicable.”

#### **Appendix A to Part 84 – Contract Provisions**

- 1) Equal Employment Opportunity: All contracts shall contain a provision requiring compliance with E.O. 11246, “Equal Employment Opportunity.”
- 2) Copeland “Anti-Kickback” Act (18 U.S.C. [United States Code] 874 and 40 U.S.C. 276c): All contracts and subgrants in excess of \$2000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland “Anti-Kickback” Act (18 U.S.C. 874).



- 3) Davis-Bacon Act, as amended (40 U.S.C. 276a to a-7): When required by Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than \$2000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7).
- 4) Contract Work Hours and Safety Standards Act (40 U.S.C. 327 through 333): Where applicable, all contracts awarded by recipients in excess of \$2000 for construction contracts and in excess of \$2500 for other contracts that involve the employment of mechanics or laborers shall include a provision for compliance with Sections 102 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333).
- 5) Rights to Inventions Made Under a Contract or Agreement: Contracts or agreements for the performance of experimental, developmental, or research work shall provide for the rights of the Federal Government and the recipient in any resulting invention in accordance with 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements," and any implementing regulations issued by HUD.
- 6) Clean Air Act (42 U.S.C. 7401 *et seq.*) and the Federal Water Pollution Control Act (33 U.S.C. 1251 *et seq.*), as amended: Contracts and subgrants of amounts in excess of \$100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401 *et seq.*) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251 *et seq.*).
- 7) Byrd Anti-Lobbying Amendment (31 U.S.C. 1352): Contractors who apply or bid for an award of \$100,000 or more shall file the required certification.