



City of West Covina, CA

Community Development Block Grant Program



To: William G. Vasquez, Director, Office of Community Planning and Development,
Los Angeles, 9DD

//SIGNED//

From: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

Subject: The City of West Covina, CA, Did Not Administer Its Community Development
Block Grant Program in Accordance With HUD Rules and Requirements

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 West Covina's Community Development Block Grant 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 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 213-534-2471.



Audit Report Number: 2015-LA-1006

Date: August 21, 2015

The City of West Covina, CA, Did Not Administer Its Community Development Block Grant Program in Accordance With HUD Rules and Requirements

Highlights

What We Audited and Why

We audited the City of West Covina's Community Development Block Grant program because of a news article¹ raising concerns about the City's financial policies and past spending practices that included the mismanagement of funds. The review was also the first time that the Office of Inspector General had conducted a review of the City. Our objective was to determine whether the City administered its program in accordance with U.S. Department of Housing and Urban Development (HUD) rules and requirements. Specifically, we wanted to determine whether the City ensured that expenditures were supported and eligible.

What We Found

The City did not operate its program in accordance with HUD rules and requirements. The City drew down \$218,324 in program funds without supporting documentation. It also made a substantial change order to a contract without following appropriate HUD requirements. The problem occurred because the City did not have program policies and procedures in place until December 2014. As a result, it incurred \$218,324 in unsupported program expenses that may not have been used to further its program national objective to benefit low- and moderate-income persons.

The City also did not comply with program timeliness spending requirements. It attributed this noncompliance to understaffing, staff turnover, and a changing census tract. As a result, the City had more than \$1.7 million in unspent program funds that had not been used toward meeting its program national objectives. However, the Los Angeles Office of Community Planning and Development was working with the City to address this issue.

What We Recommend

We recommend that the Director of HUD's Los Angeles Office of Community Planning and Development require the City to (1) support the \$218,324 in questioned costs, (2) ensure that it fully implements its program internal policies and procedures executed in December 2014, (3) revise its procurement policies and procedures to ensure that current and future procurements of

¹San Gabriel Valley Tribune: Local, state officials call for state controller's audit of West Covina posted on April 27, 2014.

goods and services comply with HUD rules and requirements, and (4) execute a workout plan with the Los Angeles Office of Community Planning and Development to ensure that it meets its timeliness requirements. If the funds are not spent in accordance with the workout plan, the Office of Community Planning and Development should take appropriate actions against the City.

Table of Contents

Background and Objective.....	3
Results of Audit	4
Finding 1: The City Did Not Always Spend Program Funds in Accordance With HUD Rules and Requirements.....	4
Finding 2: The City Did Not Comply With Program Spending Requirements.....	7
Scope and Methodology.....	9
Internal Controls.....	10
Appendixes.....	11
A. Schedule of Questioned Costs	11
B. Auditee Comments and OIG’s Evaluation	12
C. Criteria.....	15

Background and Objective

The City of West Covina, CA, is a recipient of the U.S. Department of Housing and Urban Development's (HUD) Community Development Block Grant (CDBG) entitlement program funds. The program funds are intended to help the City develop viable urban communities by providing decent housing and a suitable living environment and by expanding economic opportunities, principally for low- and moderate-income persons. The program is authorized under Title 1 of the Housing and Community Development Act of 1974, Public Law 93-383, as amended (42 U.S.C. (United States Code) 530.1 et seq).

The City was awarded more than \$2.4 million in funding through the HUD program for program years 2012 through 2014. As of April 13, 2015, HUD's Line of Credit Control System² reports showed that the City had drawn down \$790,196 in program funds. The City identified the following objectives for its use of program funds:

1. Provide decent housing. The City includes a wide range of housing activities under the program. It focuses on housing programs in which the purpose of the program is to meet individual family or community needs and does not include programs in which housing is an element of a larger communitywide improvement effort. The latter programs are more appropriately reported under the "creating a suitable living environment" objective.
2. Creating a suitable living environment. The City will undertake activities to benefit communities, families, or individuals by addressing issues in their living environment.
3. Creating economic opportunities. The City will undertake activities related to economic development, commercial revitalization, or job creation.

The City's Community Services Department manages the program funds to meet these objectives.

The objective of our audit was to determine whether the City administered its program in accordance with applicable HUD rules and requirements. Specifically, we wanted to determine whether the City ensured that expenditures were supported and eligible.

² The Line of Credit Control System (LOCCS) is HUD's primary grant disbursement system, used for handling disbursements for the majority of HUD programs.

Results of Audit

Finding 1: The City Did Not Always Spend Program Funds in Accordance With HUD Rules and Requirements

The City did not always spend program funds in accordance with requirements. Specifically, it paid \$218,324 for expenses for which it could not support the eligibility. It also approved a change order that increased the original construction contract without required documentation to justify the cost increase. The problems occurred because before December 2014, the City did not have policies and procedures in place to monitor and ensure that questioned costs were supported and eligible. In addition, the City used general procurement procedures, which did not take into consideration applicable HUD rules and requirements that would have ensured complete documentation of its procurement actions. As a result, it incurred \$218,324 in unsupported expenses and raised concerns about the justification and use of program funds.

The City Reimbursed for Unsupported Expenses

We reviewed \$278,156 in program expenditures and found that the City reimbursed \$218,324 in contractors' expenses for three CDBG-funded projects (table below) for which it could not provide supporting documentation in accordance with 24 CFR (Code of Federal Regulations) 570.506(h) (see appendix C).

Voucher number	Activity name	Voucher amount	Unsupported costs
5618655	Residential street rehabilitation–CDBG	\$60,220	\$60,220
5673796	Street barrier removals	\$66,308	\$66,308
5634384	ADA tot lot–wood chips	\$93,408	\$91,796
Total		\$219,936	\$218,324

The City departments, such as the engineering or building and safety division, collected the documents from contractors and vendors to submit to the City's finance department for processing and payment. The submitted documents included invoices from contractors with only brief descriptions and the lump sum of the amount to be reimbursed. Invoices did not include details, such as what was performed or a breakdown of materials or labor costs. These departments did not ensure that expenditures had been incurred to support the reimbursements. Source documentation, such as receipts for materials and labor, were needed to show whether items were purchased or rehabilitated and the costs were reimbursed according to the scope of work.

The City explained that expenditure reports were generated from its accounting system and it maintained a spreadsheet to track the amount that needed to be drawn for reimbursement. The Community Services Department created a voucher for the activity for the amounts to be drawn, which was sent to the Finance Department for processing and payment. This process was

inadequate because it did not support the eligibility of the funds spent. The City contacted the contractors to obtain the source documentation. This condition occurred because before December 2014, the City did not have policies and procedures in place to monitor and ensure that program costs were supported and eligible. In December 2014, it implemented new program internal policies and procedures to ensure that source documentation was obtained before payment was made.

The City Inappropriately Approved a Material Contract Change Order

On June 4, 2013, the City councilmembers approved a construction contract for \$782,215³ for the rehabilitation of 28 residential streets. On July 2, 2013, the councilmembers approved a change order that increased the contract from \$782,215 to more than \$2.1 million, which allowed the contractor to perform additional construction work on 16 more residential streets. Although the City obtained approval from councilmembers for the material change order, there was no documentation to show that it performed a cost or price analysis as required by 24 CFR 85.36(f)(1) (see appendix C).

The City noted in its files only that the increase in the contract was due to favorable pricing conditions. Regulations at 24 CFR 85.36(g)(2)(v) required that the City make available preaward review procurement documents, such as proposals or invitations for bids, independent cost estimates, etc., when a proposed contract modification changed the scope of a contract or increased the contract amount by more than \$100,000 (see appendix C). This condition occurred because the City had policies and procedures that were separate from its implemented December 2014 program procedures, which did not consider applicable HUD rules and regulations to ensure proper documentation of its program-funded procurement actions. The City's lack of consideration of HUD rules and requirements for procurement actions raised concerns that it may have spent more program funds toward projects than needed. Since program funds were not significant to the contract, only \$85,000 of the total contract of more than \$2.1 million, or 4 percent, we did not question the eligibility of the related costs; however, it is important that the City maintain complete documentation to ensure compliance with procurement requirements for its current and future contracts to minimize the risk or concerns regarding its use of HUD funds.

Conclusion

The City did not always spend program funds according to HUD rules and requirements. It incurred \$218,324 in questioned costs and approved a change order that materially increased the original construction contract without required documentation justifying the cost increase. These conditions occurred because before December 2014, the City did not have program policies and procedures to ensure that source documentation was used to support program expenses and that it followed applicable HUD rules and requirements for its procurement procedures. As a result, it reimbursed \$218,324 in unsupported costs, which would not have ensured that the program

³ The construction contract was for \$782,215. However, the project funding totaled \$919,281, including preliminary engineering, contingency, administration, etc. Of the \$919,281, \$340,029 (37 percent) was funded with CDBG funds.

national objective to benefit low- and moderate-income persons was met. Further, the City's lack of consideration of HUD procurement rules and requirements raised concerns about the justification and use of program funds.

Recommendations

We recommend that the Director of HUD's Los Angeles Office of Community Planning and Development require the City to

- 1A. Support the eligibility of the \$218,324 in questioned costs or repay the U.S. Treasury using non-Federal funds.
- 1B. Ensure that it has fully implemented its program internal policies and procedures, executed in December 2014, to comply with HUD rules and requirements.
- 1C. Revise its general internal procurement policies and procedures to ensure that current and future procurement of HUD-funded goods and services complies with HUD rules and regulations.

Finding 2: The City Did Not Comply With Program Spending Requirements

The City did not ensure compliance with program timeliness spending requirements, and as of April 13, 2015, it had spent only \$790,196 of its more than \$2.4 million in program funds. This condition occurred due to understaffing, staff turnover, and the development of a new census tract that made once-qualified projects no longer qualified. As a result, more than \$1.7 million in unspent program funds had not been used toward meeting the City's program national objective to benefit low- and moderate-income persons.

The City Did Not Comply With Program Spending Requirements

The City did not meet program timeliness spending requirements. It received more than \$2.4 million in program funds for program years 2012 through 2014. Of that amount, as of April 13, 2015, it had spent only \$790,196, or 32 percent, of its allocated funds. Further, the City had spent only funds from its 2012 program year and none from its 2013 and 2014 program years. It had not spent more than \$1.7 million of its more than \$2.4 million (68 percent) in program funds.

HUD regulations at 24 CFR 570.902(a)(1)(i) require that HUD consider the City to be failing to carry out its program activities if "sixty days prior to the end of the grantee's current program year, the amount of entitlement grant funds available to the recipient under grant agreements but undisbursed by the U.S. Treasury is more than 1.5 times the entitlement grant amount for its current program year" (appendix C). According to HUD's Integrated Disbursement and Information System⁴, it had 2.16 times the amount in available program funds for its current program year, thereby not meeting HUD's timeliness requirement. The City stated that this problem occurred due to understaffing and staff turnover within its departments. In addition, the City explained that when the new census tract was developed, the approved projects that were once qualified were no longer qualified.

On May 18, 2015, the Los Angeles Office of Community Planning and Development issued a notification of noncompliance with regulatory expenditure rate letter to the City requiring it to submit a workout plan with proposals for corrective action related to the timeliness requirement issue. The first quarterly workout plan report is due no later than October 30, 2015. The Los Angeles Office also required the City to provide quarterly reports until the timeliness standard is met.

Conclusion

The City did not comply with the program timeliness spending requirements. It had spent only \$790,196 of its more than \$2.4 million in allocated program funds. This condition occurred because the City was understaffed and had staff turnover. In addition, the City explained that when the new census tract was developed, the approved projects that were once qualified were

⁴ The Integrated Disbursement and Information System (IDIS) provides HUD with current information regarding the program activities underway across the Nation, including funding data.

no longer qualified. As a result, the City had more than \$1.7 million in unspent program funds that it had not used toward meeting its program national objective to benefit low- and moderate-income persons and is at risk of losing the funds if it does not spend them.

Recommendations

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

- 2A. Execute a workout plan to ensure that it meets the program timeliness spending requirements. If the funds are not spent in accordance with the workout plan, the Los Angeles Office of Community Planning and Development should take the appropriate actions against the City.

Scope and Methodology

We performed our onsite work at the City's offices located at 1444 West Garvey Avenue South, West Covina, CA, from April to June 2015. Our audit work was grant specific, covered the period October 1, 2011, to September 30, 2014, and was expanded as necessary.

To accomplish our audit objective, we

- Reviewed relevant HUD program requirements and regulations,
- Reviewed the City's policies and procedures,
- Reviewed executed agreements,
- Reviewed information from HUD's Line of Credit Control System,
- Reviewed information from HUD's Integrated Disbursement and Information System,
- Reviewed files and expenditures that pertained to reviewed vouchers,
- Reviewed relevant board minutes and resolutions, and
- Interviewed City personnel responsible for administering the program.

We selected a nonstatistical sample based on the highest dollar amount for the grants within our audit period. As of April 13, 2015, the City had spent only its 2012 program funds. It had not spent its grant funds for years 2013 and 2014.

HUD awarded the City more than \$2.4 million in program funds for grant years 2012 through 2014. Of this amount, the City had spent only \$790,196. Our sample included a review of four vouchers totaling \$278,156.

Computer-processed data generated by the City were not used to materially support our audit findings, conclusions, and recommendations. However, we assessed the City's accounting system and the reports it generated and determined the information to be reasonably reliable.

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 objective.

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 objective:

- Effectiveness and efficiency of program operations – Implementation of policies and procedures to ensure that program funds are used for eligible purposes.
- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to support eligible program expenditures.
- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure that the monitoring of and expenditures for program activities comply with applicable HUD rules and requirements.

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 Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The City did not have policies and procedures in place to ensure that program funds were used in compliance with HUD rules and requirements (findings 1 and 2).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A	\$218,324
Totals	\$218,324

- 1/ 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.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments



August 11, 2015

Ms. Tanya E. Schulze, Regional Inspector General for Audit
U.S. Department of Housing of Urban Development
Office of Inspector General
Office of Audit (Region 9)
611 W. Sixth Street, Suite 1160
Los Angeles, CA 91790

Dear Ms. Schulze:

We appreciate having had the opportunity to meet with you last week to discuss the draft report on the review of the City of West Covina's Community Development Block Grant (CDBG) program.

The City requests the following comments be included in the final report.

Comment regarding Finding 1:

The City acknowledges the lack of supporting documentation. The City will continue its efforts to acquire the source documentation needed to support the eligibility of the questioned costs and put measures in place to maintain these records in the future.

Comment regarding Finding 2:

The City acknowledges it is out of compliance with the timeliness requirement.

On June 5, 2015, the City initiated the required 30-day public review for substantial amendments to its 2015-2020 Strategic Plan and 2015-2016 Action Plan. The purpose of the amendments was to re-program funds obligated to activities no longer CDBG-eligible as a result of **Notice CPD-14-11: Transition Policy for LMISD Updates during FY 2014 for the Entitlement Grantees and Non-Entitlement Hawaiian County CDBG Grant**, which requires grantees to use updated census data to determine whether or not an activity meets the CDBG National Objective of providing benefit to low- and moderate-income persons on an area basis. The amendments proposed re-programming funds to eligible activities that could be expeditiously undertaken. The amendments were approved on July 7, 2015.

1444 West Garvey Avenue • West Covina • CA 91790 • Phone (626) 939-8401 • Fax (626) 939-8406

Comment 1

Comment 2

On June 11, 2015, the City submitted its workout plan, which incorporated - contingent on approval - the proposed July 7th amendments, as well as corrective actions, and details as to how the City will meet compliance with the timeliness requirement. The City's first quarterly progress report is due in October 2015.

The City will continue to work with CPD to meet compliance with the timeliness requirement.

Sincerely,



Tom Mauk
Interim City Manager

OIG Evaluation of Auditee Comments

- Comment 1 We appreciate and commend the City for taking action to obtain the source documentation to support the eligibility of the \$218,324 in questioned costs and ensure the implementation of controls to maintain program records.
- Comment 2 We appreciate the City's initiative to submit the required amendments and plans to comply with program timeliness requirements.

Appendix C

Criteria

The following sections of 24 CFR Part 85, 2 CFR Part 225, 24 CFR Part 570, and Handbook for Community Development Block Grant Subrecipients on Administrative Systems were relevant to our audit of the City's administration of program funds.

24 CFR Part 85, Administrative Requirements for Grants and Cooperative Agreements to State, Local, and Federally Recognized Indian Tribal Governments

.20, Standards for financial management systems

(b) The financial management systems of other grantees and subgrantees must meet the following standards:

(3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that is used solely for authorized purposes.

(5) Allowable cost. Applicable OMB [Office of Management and Budget] cost principles, agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

(6) Source documentation. Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.

.36, Procurement

(f) Contract cost and price. (1) Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, grantees must make independent estimates before receiving bids or proposals. A cost analysis must be performed when the offeror is required to submit the elements of his estimated cost, e.g., under professional, consulting, and architectural engineering services contracts. A cost analysis will be necessary when adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders, unless price reasonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulation. A price analysis will be used in all other instances to determine the reasonableness of the proposed contract price.

(g) Awarding agency review. (2) Grantees and subgrantees must on request make available for awarding agency pre-award review procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc. when:

(v) A proposed contract modification changes the scope of a contract or increases the contract amount by more than the simplified acquisition threshold.

.40, Monitoring and reporting program performance

(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.

2 CFR Part 225, Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87)

Appendix A to Part 225 – General Principles for Determining Allowable Costs

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

j. Be adequately documented.

24 CFR Part 570, Community Development Block Grants

Subpart J - Grant Administration

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:

(h) Financial records, in accordance with the applicable requirements listed in section 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.

Subpart O – Performance Reviews

570.902, Review to determine if CDBG funded activities are being carried out in a timely manner.

HUD will review the performance of each entitlement, HUD-administered small cities, and Insular Areas recipient to determine whether each recipient is carrying out its CDBG-assisted activities in a timely manner.

(a) Entitlement recipients and Non-entitlement CDBG grantees in Hawaii. (1) Before the funding of the next annual grant and absent contrary evidence satisfactory to HUD, HUD will consider an entitlement recipient or a non-entitlement CDBG grantees in Hawaii to be failing to carry out its CDBG activities in a timely manner if:

(i) Sixty days prior to the end of the grantee's current program year, the amount of entitlement grant funds available to the recipient under grant agreements but undisbursed by the U.S. Treasury is more than 1.5 times the entitlement grant amount for its current program year.

HUD-2005-05-CPD, Playing by the Rules – A Handbook for CDBG Subrecipients on Administrative Systems, March 2005

2.5, Source Documentation

The general standard is that all accounting records must be supported by source documentation (see 24 CFR 85.20(b)(6) and 84.21(b)(7)). Supporting documentation is necessary to show that the costs charged against CDBG funds were incurred during the effective period of the subrecipient's agreement with the grantee, were actually paid out (or properly accrued), were expended on allowable items, and had been approved by the responsible official(s) in the subrecipient organization.

The source documentation must explain the basis of the costs incurred as well as show the actual date and amount of expenditures. For example:

- With respect to payrolls, source documentation should include employment letters and all authorizations for rates of pay, benefits, and employee withholdings. Such documentation might include union agreements or minutes from board of directors' meetings where salary schedules and benefit packages are established, copies of written personnel policies, W-4 forms, etc. For staff time charged to the CDBG program activity, time and attendance records should be available. If an employee's time is split between CDBG and another funding source, there must be time distribution records supporting the allocation of charges among the sources. Canceled checks from the employees, insurance provider, etc., or evidence of direct deposits will document the actual outlay of funds.