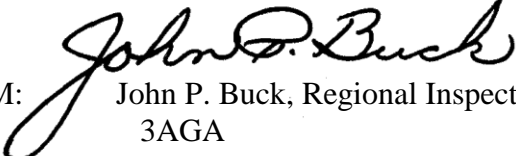




Issue Date  
February 2, 2009

Audit Report Number  
2009-PH-1005

TO: Nadab O. Bynum, Director, Philadelphia Regional Office of Community  
Planning and Development, 3AD

FROM:  John P. Buck, Regional Inspector General for Audit, Philadelphia Region,  
3AGA

SUBJECT: The City of Bethlehem, Pennsylvania, Generally Administered Its Community  
Development Block Grant Program in Accordance with HUD Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We performed an audit of the City of Bethlehem's (City) Community Development Block Grant (CDBG) program as a result of a citizen complaint.

Our audit objective was to determine whether the City administered its CDBG program in compliance with U.S. Department of Housing and Urban Development (HUD) requirements. We focused our review on whether the City (1) had adequate internal controls over its management process, accounting, and data processing; (2) used CDBG program funds for eligible activities; (3) used CDBG funds to meet the program's national objectives; and (4) properly accounted for CDBG program income.

### **What We Found**

The City generally administered its CDBG program in compliance with HUD requirements.

## **Auditee's Response**

We provided the auditee the final report on February 2, 2009.

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## BACKGROUND AND OBJECTIVES

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The Community Development Block Grant (CDBG) program was created under Title I of the Housing and Community Development Act of 1974, as amended, and is regulated by 24 CFR [*Code of Federal Regulations*] Part 570. The program provides annual grants on a formula basis to entitled cities and counties to 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 U.S. Department of Housing and Urban Development (HUD) awards grants to entitlement community grantees to carry out a wide range of community development activities directed toward revitalizing neighborhoods, economic development, and providing improved community facilities and services. Entitlement communities develop their own programs and funding priorities. Grantees must use the funds for an eligible activity that meets one or more of the CDBG program's national objectives, which are to (1) benefit low- and moderate-income persons, (2) aid in the prevention or elimination of slums or blight, and (3) meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community and other financial resources are not available to meet such needs. CDBG funds may not be used for activities which do not meet these broad national objectives.

HUD has designated the City of Bethlehem (City) an entitlement community eligible to receive funding from the Office of Community Planning and Development annually. HUD awarded the City \$1.7 million in CDBG funding annually in fiscal years 2006, 2007, and 2008.

The City was incorporated in 1962 under the provisions of the constitution and general statutes of the Commonwealth of Pennsylvania. It is a third class city, as defined by the state statutes. It operates under a mayor-council form of government and provides a full range of services including public safety, roads, sanitation, health, culture and recreation, and general government services. The City administers the CDBG program through its Department of Community and Economic Development. A director manages the daily operations of the department, which maintains its records at 10 East Church Street, Bethlehem, Pennsylvania.

Our audit objective was to determine whether the City administered its CDBG program in compliance with HUD requirements. Specifically, we wanted to determine whether the City (1) had adequate internal controls over its management process, accounting, and data processing, (2) used CDBG funds for eligible activities, (3) used CDBG funds to meet the program's national objectives, and (4) properly accounted for program income.

## RESULTS OF AUDIT

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### The City Generally Administered Its CDBG Program in Accordance with HUD Requirements

The City had adequate internal controls over its management process, accounting, and data processing and used its program funds for eligible activities that met the program's national objectives. Additionally, the City properly accounted for CDBG program income and had taken corrective action to ensure that its CDBG program income was reported and recorded in a timely manner.

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#### **The City's Internal Controls and Financial Management System Were Adequate**

The City's accounting department was a separate entity from its community development department. The community development staff reviewed all incoming invoices before sending them to the accounting department for additional review and payment. The City's accounting policies and procedures reasonably ensured that program implementation was consistent with HUD laws and regulations. Its financial management/accounting software was adequate to account for all financial transactions made by the City related to its CDBG program. In addition, its CDBG activities were included in its HUD-approved action plans, it had adequate policies and procedures governing its economic development loan programs, and it adequately monitored its subrecipients.

#### **The City Made Expenditures for Eligible Activities**

The City used its funds for eligible CDBG activities. We reviewed all 11 economic development loans, valued at \$469,251, that were reported in the City's financial records between December 1, 2006 and June 12, 2008, as being outstanding for less than 2.5 years to determine whether the related activities were eligible. We reviewed the economic development loans because the complainant alleged that the City made inappropriate float loans. Regulations at 24 CFR [Code of Federal Regulations] 570.301(b) state that a recipient may use undisbursed program funds that are budgeted in statements or action plans for one or more other activities that do not need the funds immediately, subject to specific limitations. These funds are referred to as "the float." Whenever the recipient proposes to fund an activity with the float, it must include the activity in its action

plan or amend the action plan for the current program year. The City did not identify any float-funded activities in its action plan provided to HUD for its CDBG program in 2006, 2007, or 2008. Documentation in the loan files showed that the loans were not float loans. Instead, although the loans appeared in the City's financial records to have been outstanding for less than 2.5 years, they were actually loans that had been modified in the City's financial records as a result of its obtaining private debt financing. Specifically, of the \$469,251 in CDBG funds initially disbursed, the City obtained private debt financing totaling \$346,634 from financial institutions to replace and secure the CDBG funds that it disbursed initially. Thus, the City was ultimately responsible for only \$122,617 in CDBG funds related to these loans. In addition, we nonstatistically selected 10 expenditures of CDBG funds totaling \$51,690 that the City made between December 2006 and April 2008. Documentation supporting the expenditures showed that the related activities were eligible.

### **The City's Expenditures Met the Program's National Objectives**

The activities related to the 11 economic development loans and the 10 expenditures identified above met the CDBG program's national objectives. The City issued three of the economic development loans, valued at \$160,500, under its Fund for Revitalization and Economic Development program. The intent of this program is to provide an economic development tool to furnish low interest rate financing to firms that will create and/or retain employment opportunities for low- to moderate-income City residents and enhance the City's tax base. This loan program met the CDBG program's national objective of providing activities that benefit low- and moderate-income persons. The City issued the remaining eight economic development loans, valued at \$308,751, under its Façade Program. The City established its Façade Program to provide property owners with incentives to restore, rehabilitate, or otherwise improve the façade of their buildings. This loan program met the CDBG program's national objective of providing activities which aid in the prevention or elimination of slums or blight. Of the 10 expenditures reviewed, the City made six, valued at \$19,928, related to activities which aided in the prevention or elimination of slums or blight. It made two expenditures, valued at \$25,075, related to activities benefiting low- and moderate-income persons and it made two expenditures, valued at \$6,687, for administration costs related to its housing rehabilitation program.

## **The City Properly Accounted for Program Income**

Although the City did not always report program income in a timely manner, it spent the program income before drawing additional CDBG funds. The City has taken corrective action to ensure that its CDBG program income was reported and recorded in a timely manner. The regulations at 24 CFR 570.504(a) require that the receipt and expenditure of program income be recorded as part of the financial transactions of the grant program. Further, the regulations at 24 CFR 570.504(b)(1) and (2) state that program income received before grant closeout may be retained by the recipient if the income is treated as additional CDBG funds subject to all applicable requirements governing the use of CDBG funds. If the recipient chooses to retain program income, that program income shall be disposed of before drawing additional CDBG funds for the same activity. For example, in the citizen complaint, it was alleged that the City did not report \$300,000 in program income in its financial records as it was earned or during the year in which it was earned. However, the City deposited the \$300,000 into its escrow bank account for 21 days before transferring it to its CDBG program bank account. The City used the program income for program expenditures in January 2007 before drawing additional CDBG funds. The City was made aware of the potential problems associated with delayed reporting of program income by its independent auditor in October 2007 and corrected the problem.

## **Conclusion**

The City generally administered its CDBG program in accordance with HUD requirements.

## SCOPE AND METHODOLOGY

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We conducted the audit at the City's offices in Bethlehem, Pennsylvania, from May through December 2008. The audit covered transactions representative of operations current at the time of the audit and included the period December 2006 through April 2008. We expanded the scope of the audit as necessary. We discussed operations with responsible City employees and officials from HUD's Philadelphia, Pennsylvania, field office. To accomplish our audit objective, we

- Reviewed applicable legislation, regulations, and HUD handbooks/guidebooks.
- Reviewed the City's policies and procedures for the organization's accounting controls, procurement practices, and monitoring policies to ensure that they were consistent with HUD requirements.
- Evaluated the internal controls and conducted sufficient tests to determine whether the controls functioned as intended.
- Identified and examined controls over computer systems to identify sources of data, the relevance of data, and the reliability of the systems.
- Reviewed the City's fiscal years 2005 and 2006 audited financial statements and its 2006, 2007, and 2008 annual CDBG plans.
- Reviewed all 11 of the City's economic development loans totaling \$469,251 that were outstanding for less than 2.5 years from the 168 economic development loans valued at more than \$2.6 million that were reported in the City's financial records between December 1, 2006 and June 12, 2008.
- Reviewed the City's accounting for \$300,000 in CDBG program income that it received in December 2006.
- Nonstatistically selected and reviewed 10 expenditures totaling \$51,690 from a universe more than \$2.4 million in expenditures that the City made between December 2006 and April 2008.

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 conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objective.



# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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 objective:

- Compliance with applicable laws, regulations, and provisions of program agreements – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Program operations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## **Significant Weaknesses**

We did not identify any significant weaknesses in the relevant controls identified above.

# APPENDIXES

## Appendix A

### AUDITEE COMMENTS



DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT

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January 28, 2009

John P. Buck, Regional Inspector General for Audit  
U. S. Department of Housing and Urban Development  
Wanamaker Building, Suite 1005  
100 Penn Square East  
Philadelphia, PA 19107-3380

Dear Mr. Buck,

The purpose of this letter is to acknowledge receipt of the Draft Audit Report sent to us by your office. My staff and I have reviewed the draft and are in agreement with the findings of the Office of the Inspector General. On behalf of the City of Bethlehem, I accept the OIG audit report as prepared.

It is my understanding that upon your receipt of this letter, steps will be taken to finalize and post the report. We await receipt of the final report. Thank you.

Sincerely,

A handwritten signature in black ink, appearing to read "Tony Hanna", is written over a large, light-colored circular stamp or watermark.

Tony Hanna  
Director of Community and Economic Development

TH/da

Cc: I. Woodward  
D. Albright



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