

GAO

Fact Sheet for the Honorable John Heinz
and the Honorable Arlen Specter, United
States Senate

November 1986

**COMMUNITY
DEVELOPMENT**

**HUD's Decision to
Restrict Philadelphia's
Block Grant Funds**



037455



Resources, Community, and
Economic Development Division

B-225234

November 21, 1986

The Honorable John Heinz
United States Senate

The Honorable Arlen Specter
United States Senate

Pursuant to your August 8, 1986, letter and subsequent discussions with your offices, we are providing information on events surrounding the Department of Housing and Urban Development's (HUD) decision to restrict the City of Philadelphia's Community Development Block Grant (CDBG) funds.

In summary, we found that between June 1984 and September 1986, HUD's Philadelphia Regional Office had issued several reports to and held discussions with officials of Philadelphia's Office of Housing about weaknesses in the city's management of CDBG funds. During that time, HUD's Office of Inspector General and the Philadelphia City Controller's Office had also issued reports citing similar problems. In general, the HUD regional office reported that the city had

- deficiencies in its (1) financial management controls, (2) allocation of program costs, and (3) monitoring of program activities,
- not established a follow-up system to help ensure that the reported deficiencies were being properly corrected, and
- not taken corrective measures applicable to all organizations assisting in the city's CDBG activities but only corrected weaknesses at specific organizations identified in the reports.

Accordingly, HUD's Philadelphia Regional Office notified the city's Director of Housing on July 10, 1986, that the city could not enter into new agreements with assisting organizations, or obligate any additional funds until it established controls to prevent the recurrence of deficiencies found by HUD in prior reviews. In August 1986, the regional office lifted the restriction on new agreements with assisting organizations, except for those with continuing serious

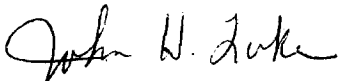
deficiencies. On September 18, 1986, the regional office approved Philadelphia's fiscal year 1986 \$52 million grant. However, it held back \$13 million of the \$52 million until the city implemented effective management systems to control and monitor its program.

To identify the events surrounding HUD's decision to restrict the city's CDBG funds, we reviewed reports on the city's CDBG activities that were issued by HUD's Philadelphia Regional Office and Office of Inspector General and the City Controller's Office during the period June 1984 to September 1986. Also, we reviewed official correspondence between the city and HUD's regional office related to the matters discussed in the reports and to the decision to restrict the funds. Further, we interviewed officials who were responsible for CDBG activities at HUD headquarters, HUD's Philadelphia Regional Office, and the City of Philadelphia.

A chronology of events which took place between the City of Philadelphia and HUD from June 1984 to September 1986 is provided as section 1. We discussed the report contents with HUD and city officials and incorporated their comments where appropriate. They generally concurred that the report accurately reflects the events surrounding HUD's actions.

As agreed with your staff, copies of the report will also be sent today to the Director of Housing, City of Philadelphia; the Secretary of HUD; the Regional Administrator, HUD Philadelphia Regional Office; and other interested parties. We will also make it available to others upon request. If you or your staff have any questions concerning this report, please call me on (202) 275-6111.

Sincerely yours,



John H. Luke
Associate Director

SECTION 1

CHRONOLOGY OF EVENTS

The following events surrounding the Department of Housing and Urban Development's (HUD) Philadelphia Regional Office decision to restrict Philadelphia's Community Development Block Grant (CDBG) occurred between June 1984 and September 1986.

June 4, 1984

HUD's Philadelphia Regional Administrator issued a fiscal year 1984 report to the Mayor of Philadelphia on the city's CDBG program activities that are primarily administered by the city's Office of Housing and Department of Commerce. The report also addressed activities of organizations such as the Philadelphia Housing Development Corporation and the Redevelopment Authority, which assist the primary city agencies in administering the program. Hereinafter, these agencies and organizations are collectively referred to as the city. HUD found that the city should improve (1) the monitoring of program activities, (2) the allocation of administrative costs, and (3) cash management practices.

July 27, 1984

In a letter to the HUD Regional Administrator, the city's Director of Housing outlined the various corrective actions the city had taken or planned to take in response to HUD's June 4, 1984, report. Among other things, the city established an inter-agency task force to identify and catalogue income sources and developed a system for managing program income. Also, the Philadelphia Housing Development Corporation developed a new fiscal procedures manual to help correct deficiencies noted in the areas of financial management and administrative costs.

October 23, 1984

HUD's regional office notified the Director of Housing that the corrective actions included in the July 27, 1984, letter did not adequately address all of HUD's findings and recommendations. HUD requested additional information as to what actions the city planned to take to correct these deficiencies. For example, regarding program accountability, HUD asked the city to provide progress reports on the system being developed for controlling, reporting, and using program income. Also, HUD asked the city to describe the planned actions for ensuring that

adequate source documentation is available for justifying program costs.

December 11, 1984

The city's Director of Housing provided additional information to HUD and requested more time to respond to some of HUD's concerns. For example, the city requested until March 31, 1985, to submit its first progress report on its accounting for program income.

April 4, 1985

The city's Director of Housing responded to HUD on the unresolved findings identified in HUD's June 1984 report pertaining to the Philadelphia Department of Commerce's role in managing its CDBG activities. These findings included the use and administration of program income, drawdown of funds for loan settlements that did not occur as scheduled, and the potential for double counting assistance benefits.

June 6, 1985

HUD's regional office issued its fiscal year 1985 report to the mayor on the city's CDBG program activities. One of the main objectives of that review was to evaluate the progress made by the city in correcting deficiencies noted in HUD's fiscal year 1984 report. The report contained 11 findings including the following areas: (1) delays occurring in implementing adequate corrective procedures led to more violations regarding the use and reporting of program income, (2) reimbursements to assisting organizations were made without verifying that the costs being charged to the program were eligible, allowable, reasonable and supported by adequate documentation, (3) the monitoring of administrative costs was lacking, and (4) there is a need to improve systems used to document eligibility and fundability of activities, including the program requirement that 51 percent of CDBG funds benefit low- and moderate-income households. Notwithstanding these findings, HUD said it found that a significant improvement had occurred in the areas reviewed and city officials now had a greater awareness of program requirements.

June 10, 1985

The Office of the City Controller notified HUD's regional office of a potential misuse of funds involving the Inner City Organizing Network--an organization under contract to

carry out CDBG program activities. The City Controller said that an audit by the city's Director of Finance disclosed numerous substantial deficiencies in the Inner City Organizing Network's accounting records and procedures, a lack of internal controls, an apparent conflict of interest involving the Network's executive director, and other serious matters. The controller said city auditors were called in after an audit report issued by an independent public accounting firm disclaimed an opinion because of a lack of supporting documentation for costs incurred by the Inner City Organizing Network.

June 18, 1985, July 23, 1985, and August 16, 1985

The city's Director of Housing informed the HUD regional office of the actions the city had taken or had planned to take on the June 6, 1985, report. Among other things, the city said one organization was notified to use its program income in accordance with regulations; procedures were developed in order to make and document the eligibility and fundability of activities; program income procedures were revised to correct deficiencies HUD noted in multiple CDBG-funded contracts; and a computerized tracking system was being developed to exercise tighter controls over costs.

July 8, 1985

HUD's regional office informed the city's Office of Housing that it recently learned of the situation involving the potential misuse of funds by the Inner City Organizing Network. HUD recognized that the Office of Housing was aware of the situation and that follow-up action had been initiated. HUD requested that within 14 days a report be provided describing the actions being taken to correct the specific accounting and internal control weaknesses cited by the City Finance Director. HUD also suggested a number of actions the city should take to correct the situation.

July 19, 1985

The city's Director of Housing provided information to HUD on actions taken by the Office of Housing and other city departments to correct the deficiencies concerning the Inner City Organizing Network, including an investigation by the Philadelphia District Attorney's Office into the Network's finances.

September 20, 1985

HUD's regional office told the Director of Housing that based on the information submitted and actions taken between June and August 1985, 5 of the 11 findings reported in its June 6, 1985, report were cleared and 1 was partially cleared. HUD asked the city to provide additional information on the six unresolved findings. HUD said that, with one exception, the city appeared to be addressing HUD's concerns.

November 14, 1985, December 2 and 18, 1985,
and January 29, 1986

The city's Director of Housing submitted additional information to HUD's regional office on the six unresolved findings. Among other things, the city said that administrative costs of two organizations in question would be reviewed every 2 months in accordance with the city's cost reimbursement review procedures; action had been taken to correct deficiencies in using and reporting program income; and the cost incurred by one organization was properly classified.

February 21, 1986

The city's Director of Housing further responded to HUD's July 8, 1985, letter with a preliminary report on the potential misuse of CDBG funds by the Inner City Organizing Network. The report discussed the (1) level of services provided, (2) use of at least \$36,000 of program funds for renovating a building, and (3) employment of the Network's executive director as a consultant to the organization.

March 10, 1986

HUD's regional office told the city's Director of Housing that based on the city's responses to the September 20, 1985, letter, 10 of the 11 findings in its June 6, 1985, report were resolved. The unresolved finding dealt with ineligible program costs. In addition to requesting additional information on the unresolved finding, HUD raised some questions regarding two findings (improper allocation of costs and classification of program income) previously cleared and requested the city to provide additional information.

March 21, 1986 and April 10, 1986

The city's Office of Housing provided HUD information in response to its March 10, 1986, letter. The city reimbursed the CDBG fund about \$27,000 for ineligible recreation activities charged to the fund in 1984 which cleared a portion of the remaining unresolved finding. Also, the city reported that the cash received by one organization after June 30, 1984, was used as program income as HUD recommended.

May 2, 1986

HUD's regional office reported on the CDBG activities administered by the city's Department of Commerce through the Philadelphia Industrial Development Corporation and the Philadelphia Citywide Development Corporation. However, HUD told the city that the report was not applicable solely to commerce's activities. Rather, HUD said the comments were based on conclusions reached after extensive monitoring of the city's entire CDBG Program. HUD's findings concerned failure to adequately document cost and monitor program requirements. HUD said that many deficiencies were caused by organizations which did not understand program requirements. Also, HUD said it found that the city's Commerce Department did not provide adequate oversight of CDBG activities. Further, HUD said the city was spending too much time writing contracts, processing payments, and granting up-front approvals instead of reviewing activities, internal controls, and management systems.

May 29, 1986

HUD's regional office reported on the fiscal procedures followed by the Philadelphia Housing Development Corporation. HUD found the following: (1) funds were improperly placed in escrow in advance of incurring costs--a violation of cash drawdown procedures, (2) program income was improperly reported, (3) assisting organizations had improperly classified and charged administrative expenses, (4) indirect costs were improperly allocated, and (5) financial management systems were improperly monitored. HUD also told the city that deficiencies cited in the June 6, 1985, report regarding the reporting and use of program income still were not corrected. HUD warned the city that if the deficiencies were not corrected expeditiously, additional remedial actions would be considered.

June 10, 1986

HUD's regional office told the city's Director of Housing that on the basis of responses to the March 10, 1986, letter, it cleared a portion of the unresolved finding cited in its June 6, 1985, report. HUD, however, was still concerned with the way one organization classified an interfund receivable, escrowed cash retained on contract, and allocated certain costs. HUD said that the allocation of cost issue was under review because of a finding discussed in an audit report on the city's 1984 program activities issued by the City Controller's office on February 25, 1986.

June 12, 1986

The Director of Housing asked HUD's regional office for a 90-day extension to implement changes to the Philadelphia Housing Development Corporation's fiscal procedures recommended by HUD in its May 29, 1986, report.

June 25, 1986

The Director of Housing replied to HUD's May 2, 1986, report. She said that the city's Office of Housing and Department of Commerce coordinated their efforts and corrected the deficiencies where possible but many of the findings required follow-up work by the city. For example, the city requested 90 days to draft the revised procurement policies and procedures HUD had recommended.

June 27, 1986

HUD regional office officials met with the city's Directors of the Office of Housing and Department of Commerce to discuss whether the city had the capacity to effectively manage the CDBG Program. HUD said this concern resulted from (1) the substantial number of serious findings relating to noncompliance in all program areas and agencies, (2) the number of repeat findings cited in subsequent monitoring and auditing reports, and (3) the length of time the city took to correct basic weaknesses in its management systems. As a result, HUD told the city that restrictions would be placed on its future spending of CDBG program funds.

June 30, 1986

The city's Director of Housing requested HUD's Regional Deputy Director for Community Planning and Development to

be discussed further. HUD did not approve the director's request.

July 3, 1986

HUD's regional office denied the city's June 12, 1986, request for a 90-day extension for implementing the Philadelphia Housing Development Corporation's fiscal procedures. HUD said that the extension was not granted because it believed the corporation had had sufficient time to become familiar with the problems and implement the necessary corrective actions without additional delay. According to HUD, these changes were initially recommended in HUD's June 6, 1985, report. In response to that report, the city published a draft of the revised procedures in February 1986. However, HUD reported on May 29, 1986, that the revised procedures had not been implemented and, at that time, expressed its concern with the length of time being taken to implement the recommended changes.

July 10, 1986

HUD's regional office issued a letter prohibiting the city from entering into new contracts or increasing funding for existing contracts. HUD cited its May 1986 monitoring reports, prior monitoring reports, and auditing reports by the Office of the City Controller as evidence that the city had not fully complied with the statutory and regulatory requirements of the program. HUD's overall concern centered around the city's inability to effectively manage the CDBG Program. According to HUD, the most serious deficiencies were found in financial management controls, allocation of costs, and monitoring.

July 11, 1986

The city's Director of Housing replied to HUD's May 29, 1986, report on the Philadelphia Housing Development Corporation. The Office of Housing said it was trying to be responsive to all issues raised by HUD but additional time was needed to implement certain fiscal procedures.

July 24, 1986

HUD's Office of Inspector General reported on weaknesses it had found in the city's monitoring of financial management and accountability of program funds.

August 6, 1986

The city's Director of Housing summarized in a letter to HUD's regional office the understandings the city reached during a meeting held with HUD officials on July 28, 1986, to discuss the concerns raised in HUD's July 10, 1986, letter. The city said that it understood: (1) the July 10, 1986, letter was not intended to shut down the city's entire CDBG Program and the city could contract with organizations not affected by HUD's concerns, (2) the repeat nature of some of the findings led to HUD's actions on July 10, 1986, (3) the city's monitoring systems for program management needed to be strengthened and applied across the board, (4) resolving the issues would not take much time since some of the city's activities were following the appropriate corrective measures cited by HUD in its July 10, 1986, letter, and (5) the only problem holding up approval of the city's fiscal year 1986 grant was determining the exact date for the congressional notification letter.

August 11, 1986

The City Controller released a report dated June 27, 1986, on its review of the city's management of its fiscal year 1985 CDBG Program. The City Controller found erroneous allocation of program and administrative costs, and failure by the city to effectively monitor CDBG operations.

August 14, 1986

The Mayor of Philadelphia wrote to HUD's Regional Administrator stating that the city was prepared to take whatever steps were needed to comply with HUD's July 10, 1986, letter. The mayor's letter outlined specific actions the city would take to improve its management of the program.

August 20, 1986

The Mayor of Philadelphia sent HUD's Regional Administrator additional information the city believed would satisfy HUD's July 10, 1986, concerns. The mayor believed that this information, the city's ongoing efforts to strengthen the management and monitoring systems, and the improvements noted in the August 14, 1986, letter, had satisfied all of HUD's concerns. The mayor requested HUD to remove restrictions it imposed July 10, 1986, and asked that it approve the city's fiscal year 1986 grant.

August 22, 1986

HUD's Regional Administrator acknowledged the city's efforts to address the July 10, 1986, issues. On the basis of the city's actions, HUD said the city could contract with its assisting organizations under the current grants. However, HUD said no contracts could be entered into with any organization where serious deficiencies still existed. HUD also advised the city that it would impose a contract condition limiting the use of the city's fiscal year 1986 funds.

September 2, 1986

The city's Director of Housing asked HUD's Regional Administrator to approve the fiscal year 1986 grant as soon as possible because less than \$5 million of unobligated funds remained from prior-year grants.

September 2, 1986

The city's Director of Housing responded to the HUD Inspector General's July 24, 1986, report. The city agreed with the finding regarding the need to improve monitoring of financial management systems and said that improvements were underway. However, the city disagreed with the Inspector General's findings regarding program income and expressed its opinion that it was operating in accordance with CDBG regulations.

September 18, 1986

HUD's Regional Administrator conditionally approved the city's fiscal year 1986 grant by holding back \$13 million of the \$52 million grant until the city took corrective action on all issues HUD raised in its July 10, 1986, letter.

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