
AUDIT REPORT



HUD'S OVERSIGHT OF EMPOWERMENT ZONE
PROGRAM
OFFICE OF COMMUNITY PLANNING AND
DEVELOPMENT

MULTI-LOCATION REVIEW

2003-CH-0001

MAY 7, 2003

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



Issue Date May 7, 2003
Audit Case Number 2003-CH-0001

TO: Roy A. Bernardi, Assistant Secretary for Community Planning and Development, D

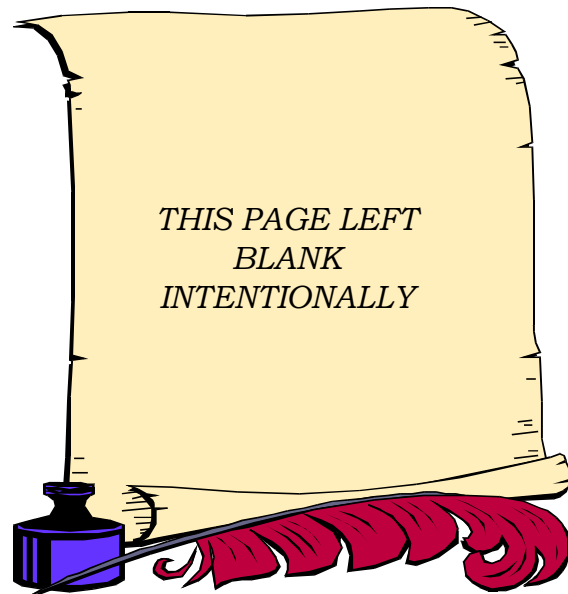
FROM: 
Heath Wolfe, Regional Inspector General for Audit, Region V

SUBJECT: HUD's Oversight of Empowerment Zone Program
Office of Community Planning and Development
Multi-Location Review

We completed a multi-location audit of the Office of Community Planning and Development's oversight of the Empowerment Zone Program. The audit was conducted based upon our review of six Empowerment Zones and two requests from Congress. The objective of our audit was to determine whether HUD had an effective system for oversight and control of the Program. The audit was part of our Fiscal Year 2002 Annual Audit Plan and resulted in two findings.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Brent Bowen, Senior Auditor, at (614) 469-5737 extension 8277 or me at (312) 353-7832.




Executive Summary

We completed a multi-location audit of the Office of Community Planning and Development's oversight of the Empowerment Zone Program. The objective of our audit was to determine whether HUD had an effective system for oversight and control of the Program. The audit was part of our Fiscal Year 2002 Annual Audit Plan. The audit was conducted based upon our review of six Empowerment Zones and two requests from Congress.

The United States House of Representatives' Conference Report 107-272 directed HUD's Office of Inspector General to review the use of Zone funds and to report our findings to the Senate Appropriations Committee. The United States Senate's Report 107-43 also requested us to review the use of Zone funds and report our audit results to Congress.

Our audit was conducted at HUD Headquarters, six Zones, and HUD's Field Offices of Community Planning and Development having jurisdiction for the six Zones we reviewed. The six Zones were Cincinnati, Ohio; Cleveland, Ohio; Huntington, West Virginia/Ironton, Ohio; Minneapolis, Minnesota; Norfolk/Portsmouth, Virginia; and St. Louis, Missouri/East St. Louis, Illinois.

We concluded that HUD's Office of Community Planning and Development lacked an adequate system of oversight and control over its Program. Specifically, the Office of Community Planning and Development needs to improve its oversight of the Cities use of HUD funds (Empowerment Zone, Section 108 Loan Guarantee, and Economic Development Initiative Grant) for the Program. Additionally, HUD's Office of Community Planning and Development did not: effectively assess the status and progress of the Cities' Programs; and adequately verify the accuracy of the June 2001 and/or 2002 Annual Reports submitted by the Cities for their Programs. Consequently, the following items resulted from HUD's inadequacies in oversight and controls: (1) HUD lacks assurance that the Cities were efficiently and effectively using their HUD funds; (2) HUD lacked accurate information to assess the Zones' progress on meeting the goals of their Strategic Plans; and (3) the impression exists that the benefits of the Program were greater than actually achieved.



Controls Over HUD Funds Were Not Adequate

HUD's Office of Community Planning and Development needs to improve its oversight of the Cities' use of HUD funds (Empowerment Zone, Section 108 Loan Guarantee, and Economic Development Initiative Grant) for the Program. HUD did not adequately confirm that the Cities' projects complied with the respective Federal requirements and their contracts with the projects' administering entities regarding the use of HUD funds. Five of the six Zones we reviewed inappropriately used some of their HUD funds for the Program.

HUD Did Not Adequately
Verify Annual Reports
Submitted By The Cities

HUD's Office of Community Planning and Development did not effectively assess the status and progress of the Cities' Programs. HUD did not adequately verify the accuracy of the June 2001 and/or 2002 Annual Reports submitted by the Cities for their Programs. The six Cities we reviewed provided inaccurate information to HUD for 38 of the 50 activities (76 percent) we evaluated from the June 30, 2001 and/or June 30, 2002 Annual Reports. The June 2001 and June 2002 Annual Reports for the six Zones we reviewed contained inaccuracies regarding the outputs of 32 projects, milestones of 26 projects, and sources and/or uses of funds of 20 projects.

Recommendations

We recommend that HUD's Assistant Secretary for Community Planning and Development assure that the Office of Community Planning and Development implements controls to correct the weaknesses cited in this report.

We presented our draft audit report to HUD's Assistant Secretary for Community Planning and Development during the audit. We held an exit conference with HUD's staff on March 28, 2003. HUD's Office of Community Planning and Development did not provide written comments on our draft audit report.

Table Of Contents

Management Memorandum	i
-----------------------	---

Executive Summary	iii
-------------------	-----

Introduction	1
--------------	---

Findings

1. Controls Over HUD Funds Were Not Adequate	5
--	---

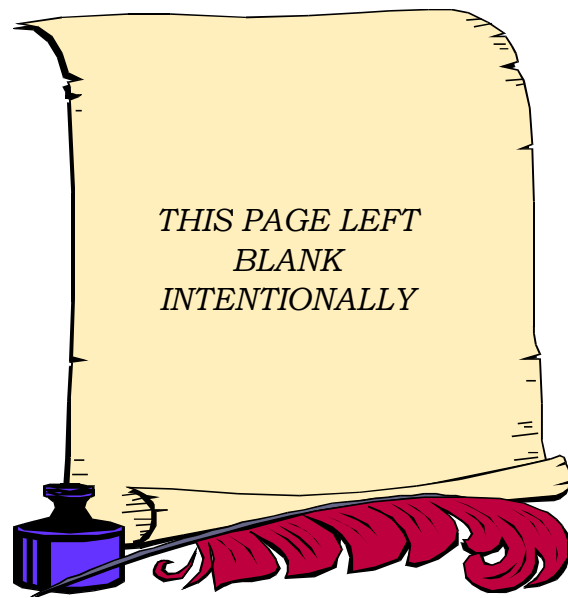
2. HUD Did Not Adequately Verify Annual Reports Submitted By The Cities	11
--	----

Management Controls	17
---------------------	----

Follow Up On Prior Audits	19
---------------------------	----

Appendix

A. Empowerment Zones Reviewed	21
-------------------------------	----



Introduction

The objective of the Empowerment Zone Program is to rebuild communities in poverty stricken inner city and rural areas by developing and implementing strategic plans. The plans are required to be based upon the following four principles: (1) creating economic opportunity for Zone residents; (2) creating sustainable community development; (3) building broad participation among community-based partners; and (4) describing a strategic vision for change in the community.

The Omnibus Budget Reconciliation Act of 1993 authorized the Program. The Reconciliation Act provided funding for the Program under Title 20 of the Social Security Act. The Program was initially designed to provide the Zones authorized by the Reconciliation Act of 1993 with \$250 million in tax benefits and \$100 million of Social Service Block Grant funds from the Department of Health and Human Services. In December 1994, HUD's former Secretary designated the following six urban areas as Round I Empowerment Zones: Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Detroit, Michigan; New York, New York; and Philadelphia, Pennsylvania/Camden, New Jersey.

HUD's former Secretary also designated two urban areas as Supplemental Empowerment Zones. The two areas were in the Cities of Cleveland, Ohio and Los Angeles, California. The Supplemental Empowerment Zones were provided funding through HUD's Economic Development Initiative and Section 108 Loan Guarantee Programs. The Taxpayer Relief Act of 1997 authorized the two Supplemental Empowerment Zones to receive tax benefits as provided under the Omnibus Budget Reconciliation Act of 1993. The City of Cleveland was granted full Round I Empowerment Zone status on January 31, 1998, but the designation did not become effective until January 1, 2000.

The Taxpayer Relief Act of 1997 also established the District of Columbia as an Empowerment Zone and authorized the former Secretary of HUD to designate 15 additional urban areas as Empowerment Zones. On January 13, 1999, HUD's former Secretary named 15 economically distressed communities as Round II Empowerment Zones. The 15 additional urban Empowerment Zones were eligible to share in HUD grants and tax-exempt bonding authority to finance revitalization and job creation over the next 10 years. The following table shows the amount of Empowerment Zone funds drawn down and spent by each of the 15 additional Empowerment Zones as of April 30, 2002.

Round II Empowerment Zones	Funding
Boston, Massachusetts	\$1,421,091
Cumberland County, New Jersey	6,017,022
Cincinnati, Ohio	2,534,471
Columbia/Sumter, South Carolina	3,863,989
Columbus, Ohio	4,103,155
El Paso, Texas	3,537,149
Gary/East Chicago/Hammond, Indiana	3,377,436
Huntington, West Virginia/Ironton, Ohio	8,282,845
Knoxville/Knox County, Tennessee	3,413,759
Miami/Dade County, Florida	2,431,148
Minneapolis, Minnesota	3,975,735
New Haven, Connecticut	3,165,771
Norfolk/Portsmouth, Virginia	8,183,156
Santa Ana, California	6,283,208
St. Louis, Missouri/East St. Louis, Illinois	2,623,661
Total	<u>\$63,213,596</u>

The Omnibus Reconciliation Act of 1993 authorized the Secretary of HUD to issue regulations needed to administer and oversee the Program. HUD’s regulations for the Program are located at 24 CFR Parts 597 and 598. The regulations require HUD to periodically determine whether the Zones should continue with their designations based upon the following information received from the Zones: verified accuracy of the information received from the Zones; approved activities submitted by the Zones; and coordinate technical assistance when requested or a need is identified.

The Department of Health and Human Services disbursed Zone funds to the States and is required to address issues concerning the permissible use of Zone funds for the original six urban areas designated as Round I Empowerment Zones. HUD is responsible for disbursing funds for the Supplemental Round I and the Round II Empowerment Zones. HUD and the Department of Health and Human Services are required to ensure that funds for the Program are used efficiently and effectively. HUD’s Renewal Communities/Empowerment Zones/Enterprise Communities Initiative staff at Headquarters performs the day-to-day oversight of the Program. The Initiative is part of HUD’s Office of Community Planning and Development.

Audit Objective

The objective of our audit was to determine whether HUD had an effective system for oversight and control for the Program.

Audit Scope And Methodology

We performed our on-site work between April 2002 and February 2003 at HUD Headquarters, six Empowerment Zones, and the respective Field Offices of Community

Planning and Development for the six Zones. The six Zones were Cincinnati, Ohio; Cleveland, Ohio; Huntington, West Virginia/Ironton, Ohio; Minneapolis, Minnesota; Norfolk/Portsmouth, Virginia; and St. Louis, Missouri/East St. Louis, Illinois. We previously issued separate audit reports for each of the six Zones we reviewed. The following table provides the report numbers and issue dates for the six Zones.

<i>Empowerment Zone</i>	<i>Report Number</i>	<i>Issue Date</i>
<i>Cincinnati, Ohio</i>	2003-CH-1009	January 28, 2003
<i>Cleveland, Ohio</i>	2003-CH-1016	April 25, 2003
<i>Huntington, West Virginia/Ironton, Ohio</i>	2003-CH-1006	December 31, 2002
<i>Minneapolis, Minnesota</i>	2003-CH-1007	January 3, 2003
<i>Norfolk/Portsmouth, Virginia</i>	2003-PH-1001	December 20, 2002
<i>St. Louis, Missouri/East St. Louis, Illinois</i>	2003-KC-1003	December 26, 2002

To determine whether HUD's Office of Community Planning and Development had an effective system for oversight and control for the Program, we interviewed the following staff at: HUD Headquarters and six Field Offices of Community Planning and Development; the six Zones; and the administering entities of the Zones' projects. Based upon the projects' reported expenditures, we selected 65 of the 217 contracts for projects reported in the Zones' June 30, 2001 and/or 2002 Annual Report. Appendix A of this report contains the projects reviewed for each of the six Zones.

To evaluate HUD's oversight and controls for the Program, we reviewed files and records maintained by: HUD Headquarters and six Field Offices of Community Planning and Development, the Cities, the administering entities of the Cities' Programs, and the projects' administering entities. We also reviewed the following documents: the Omnibus Budget Reconciliation Act of 1993; the Taxpayer Relief Act of 1997; 24 CFR Parts 85, 570, 597, and 598; Office of Management and Budget Circular A-87; the April 16, 1998 Federal Register; HUD's guidance and instructions for the Program; the six Zones' June 2001 and/or June 2002 Annual Reports; the Zones' applications, agreements, and contracts; approved payment requests related to the projects; and the administering entities'

voucher payments, monitoring files, and supporting documentation.

The audit covered the period of January 1, 1999 to April 30, 2002. This period was adjusted as necessary. We conducted our audit in accordance with Generally Accepted Government Auditing Standards.

We provided a copy of this report to HUD's Assistant Secretary for Community Planning and Development.

Controls Over HUD Funds Were Not Adequate

HUD's Office of Community Planning and Development needs to improve its oversight of HUD funds (Empowerment Zone, Section 108 Loan Guarantee, and Economic Development Initiative Grant) for the Empowerment Zone Program. HUD did not adequately confirm that Empowerment Zones' projects complied with Federal requirements and the Zones' contracts with the projects' administering entities regarding the use of HUD funds. Five of the six Zones we reviewed inappropriately used HUD funds for their Programs. The problems occurred because HUD's Office of Community Planning and Development lacked adequate procedures and controls to verify that HUD funds were used according to Program guidelines. As a result, HUD lacks assurance that the Cities were efficiently and effectively using their HUD funds.

HUD's Requirements

Chapter 7 of HUD's Program Services and Operations Manual states the EZ/EC Office sets policy for the urban Empowerment Zones and is charged by the Secretary with management and oversight of the Initiative at HUD.

HUD's On-Site Monitoring Guidance for Field Offices regarding Round II Empowerment Zones, dated April 2002, states for each of the Round II Empowerment Zones, Field Office staff is to select six Implementation Plans for on-site reviews to ensure Empowerment Zones are in compliance with applicable requirements.

HUD Did Not Have Adequate Procedures And Controls To Ensure Zone Funds Were Used Appropriately

HUD's Office of Community Planning and Development lacked adequate procedures and controls to ensure HUD funds (Empowerment Zone, Section 108 Loan Guarantee, and Economic Development Initiative Grant) were appropriately used according to Federal requirements and Zone contracts with the projects' administering entities. HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative staff at Headquarters performs the day-to-day oversight of the Program. HUD's Community Planning and Development Field Offices are responsible for monitoring Empowerment Zones to ensure HUD funds are used efficiently and effectively.

A Community Planning and Development Representative at the Columbus Field Office performed on-site reviews of six Implementation Plans from the City of Cincinnati's 2001 Annual Report. A Community Planning and Development

Representative at the Columbus Field Office did not perform an on-site review of the Implementation Plans from the City of Cleveland’s Annual Reports. A Community Planning and Development Representative at the Pittsburgh Field Office only performed an on-site review of one Implementation Plan from the Cities of Huntington/Ironton’s 2001 Annual Report. A Senior Community Planning and Development Representative at the Minneapolis Field Office only performed on-site reviews of five Implementation Plans from the City of Minneapolis’ 2001 Annual Report.

The Cities of Cincinnati, Cleveland, Huntington/Ironton, and Norfolk/Portsmouth inappropriately used HUD funds for their Programs that did not comply with Federal requirements and/or the Zone contracts with the projects’ administering entities. The City of Minneapolis also improperly used HUD funds that did not comply with its contract with a project’s administering entity; however, the amount was small (\$9,705). The following table shows the results of our review of projects at Cincinnati, Cleveland, Huntington/Ironton, and Norfolk/Portsmouth.

	Cincinnati	Cleveland	Huntington/ Ironton	Norfolk/ Portsmouth
Zone Projects Reviewed	10	10	10	18
Projects Incurring Inappropriate Or Unsupported Expenditures of HUD Funds	4	10	1	7
HUD Funds Used	\$1,958,981	\$22,015,883	\$4,697,143	\$8,900,000
HUD Funds Inappropriately Used	\$15,364	\$6,891,245	\$160,000	\$258,113
Percent of HUD Funds Inappropriately Used	.8%	31.3%	3.4%	2.9%
Unsupported HUD Funds Used	\$311,346	\$4,744,824	\$0	\$74,041
Percent of Unsupported HUD Funds Used	15.9%	21.6%	0%	.8%

As shown in the above table, the Cities of Cincinnati and Cleveland inappropriately used or lacked documentation to support that 16.7 and 52.9 percent of HUD funds benefited the Cities’ Programs or were matched with in-kind services, respectively.

HUD’s Office of Community Planning and Development Representative responsible for monitoring the City of Cleveland’s Program said HUD’s Community Planning and

Development Columbus Field Office management decided, through risk analysis, not to monitor the City's Program.

HUD's Office of Community Planning and Development Representative responsible for oversight of the City of Cincinnati's Program said he did not review supporting vouchers to determine whether expenses were eligible. The Representative said he felt that schedules of expenditures provided by the Cincinnati Empowerment Corporation, the administering entity of the City's Program, were adequate documentation to determine the eligibility of the projects' use of Zone funds.

HUD's Office of Community Planning and Development Representative responsible for monitoring the Cities of Huntington/Ironton's Program said he did not have the time to allocate toward reviewing six projects. Furthermore, he said he did not review supporting vouchers to determine whether expenses were eligible.

HUD's Office of Community Planning and Development Representative responsible for oversight of the City of Minneapolis' Program said she made a mistake by selecting only five projects to monitor.

HUD's Headquarters Renewal Communities/Empowerment Zones/Enterprise Communities Initiative did not require monitoring of the City of Cleveland's Program. Additionally, the Initiative did not review the Field Offices of Community Planning and Development's monitoring of the Cities' Programs to ensure the adequacy of the Offices' monitoring of the Cities' use of HUD funds for their Programs. As a result, HUD lacks assurance that the Cities were efficiently and effectively using their HUD funds.

The Cities Provided Zone Funds To Projects That Have Not Benefited Zone Residents Or Benefited Between 3 And 38 Percent Of Zone Residents

The City of Cleveland used \$13,207,000 of the \$13,730,000 in HUD (Section 108 Loan Guarantee and Economic Development Initiative Grant) monies committed to fund three projects that have not provided benefits to Zone residents or benefited only 25 percent of Zone residents as of November 2002. We believe the City's use of HUD funds from its Program for the Quincy Place and Glenville Town Center, Ltd. projects does not meet the City's Economic Development Initiative Grant Agreement requiring that jobs created or retained by projects funded as Section 108

Business Loans will be predominantly held by Zone residents. We believe the City's use of HUD funds for the Lassi Enterprises, L.L.C. project does not meet the City's Grant Agreement requiring that a majority of the jobs created or retained by the project's funded as 108/Economic Development Initiative Acquisition and Development Loans for businesses will be held by Zone residents.

The City of Cleveland executed contracts between May 29, 1998 and November 14, 2001 with the three projects' administering entities. None of the contracts required the projects to create or retain jobs predominantly held by Zone residents or required the majority of the jobs created or retained by the projects to be held by Zone residents. Additionally, the City's Grant Agreement does not provide a definition for predominantly held by Zone residents. Therefore, HUD must make a determination whether the City's use of HUD funds for the three projects was appropriate.

The Cities of Cincinnati, Huntington/Ironton, and Minneapolis used \$6,455,159 of the \$7,110,030 in Empowerment Zone monies committed to fund 15 projects that have not benefited Zone residents or benefited only three to 38 percent of Zone residents as of 2002. Nine of the 15 projects are scheduled for completion between December 2003 and December 2011. The remaining six projects were completed between June 2001 and November 2002. Since the nine projects spent 90 percent of their Zone funds committed, benefits to Zone residents would be expected. However, this has not occurred.

We believe the Cities' (Cincinnati, Huntington/Ironton, and Minneapolis) use of Empowerment Zone funds for the 15 projects does not meet HUD's Empowerment Zone regulation at 24 CFR Part 598.215(b)(4)(i)(D) that incorporates the Appendix from the April 16, 1998 Federal Register requiring all projects financed in whole or in part with Zone funds be structured to primarily benefit Zone residents. However, HUD must make a determination whether the Cities' use of Zone funds was appropriate.

The Cities (Cincinnati, Huntington/Ironton, and Minneapolis) or their administering entities executed contracts between July 1, 1999 and November 1, 2001 with

the 15 projects' administering entities. None of the contracts required the projects to primarily serve Zone residents. Additionally, the April 16, 1998 Federal Register does not provide a definition of primarily benefits Zone residents. HUD issued a memorandum on July 2, 2002 that provided guidance to Empowerment Zones regarding benefits to Zone residents.

HUD's July 2002 memorandum states HUD presumes an Implementation Plan is consistent with a Zone's Strategic Plan if at least a majority, 51 percent, of the beneficiaries of an activity are Zone residents. The memorandum also states that in computing the percentage of beneficiaries who are Zone residents, where the benefit is in the form of jobs, at least 35 percent of those jobs must be filled by Zone residents. Since HUD's memorandum was issued after the 15 projects were started, the memorandum cannot be used retroactively to determine the appropriateness of Zone funds used for the projects. Therefore, HUD must make a determination whether the Cities' use of Zone funds for the 15 projects was appropriate. As of March 2003, HUD is drafting additional guidance regarding the use of Zone funds to provide a determination on whether the use of the funds is benefiting Zone residents.

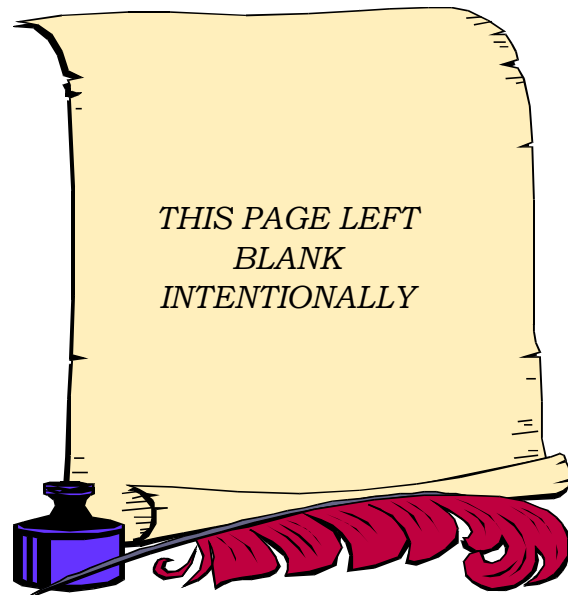
Auditee Comments

HUD's Office of Community Planning and Development did not provide written comments on our draft audit report.

Recommendations

We recommend that HUD's Assistant Secretary for Community Planning and Development assure that the Office of Community Planning and Development:

- 1A. Implements procedures and controls to ensure HUD funds (Empowerment Zone, Section 108 Loan Guarantee, and Economic Development Initiative Grant) for the Empowerment Zone Program are used efficiently and effectively.
- 1B. Issues additional guidance regarding the use of HUD funds for the Empowerment Zone Program to ensure that funds benefit Zone residents



HUD Did Not Adequately Verify Annual Reports Submitted By The Cities

HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative did not effectively assess the status and progress of the Cities' Empowerment Zone Programs. HUD did not adequately verify the accuracy of the June 2001 and/or 2002 Annual Reports submitted by the Cities for their Programs. The six Cities we reviewed provided inaccurate information to HUD for 38 of the 50 activities (76 percent) we evaluated from their June 30, 2001 and/or June 30, 2002 Annual Reports. The June 2001 and June 2002 Annual Reports for the six Empowerment Zones we reviewed contained inaccuracies regarding the outputs of 32 projects, milestones of 26 projects, and sources and/or uses of funds for 20 projects. The problems occurred because HUD lacked sufficient procedures and controls to ensure Annual Reports were adequately verified for accuracy. Furthermore, the Cities did not have adequate controls over their Annual Reports to accurately report to HUD. As a result, HUD did not have accurate information to assess the Zones' progress on meeting the goals of their Strategic Plans. The impression also exists that the benefits of the Program were greater than actually achieved.

HUD's Requirements

24 CFR Part 597.401 requires HUD to regularly evaluate the Strategic Plan in each designated Empowerment Zone on the basis of performance reviews to be conducted on-site and other information submitted.

24 CFR Part 597.402(a) requires HUD to assess the continuing eligibility of an Empowerment Zone based upon performance reviews. Determinations of whether any designated Empowerment Zone remains in good standing will be promptly communicated to all Federal agencies providing assistance or administering programs in an Empowerment Zone.

24 CFR Parts 597.403(a)(2)(3) and 598.430(a)(2)(3) allows HUD's Secretary to revoke the designation of an urban Empowerment Zone if the Secretary determines, on the basis of the periodic performance review, that the local government in which the urban area is located: has failed to make progress in achieving the benchmarks set forth in the Strategic Plan; or has not complied substantially with the Strategic Plan.

24 CFR Part 598.420 requires HUD to regularly evaluate the progress of implementation of the Strategic Plan in each

designated Empowerment Zone on the basis of available information.

24 CFR Part 598.425(a) requires HUD to assess the continuing eligibility of an Empowerment Zone based upon periodic progress determinations.

Chapter 7 of HUD's Program Services and Operations Manual states the EZ/EC Office sets policy for the urban Empowerment Zones and is charged by the Secretary with management and oversight of the Initiative at HUD.

HUD's Fiscal Year 2001 EZ/EC Annual Report Assessment Process guidance states Community Planning and Development Representatives (Public Trust Officers) are responsible for assessing the progress made toward the implementation of the Empowerment Zones' Strategic Plan. The Representatives must verify the five Implementation Plans with the largest budgets.

HUD's Verification Guidance for the EZ/EC 2001 Annual Reports states Community Planning and Development Representatives (Public Trust Officers) are responsible for obtaining reasonable documentation to substantiate a sample of the information contained in the Empowerment Zones' June 2001 Annual Reports.

HUD's Fiscal Year 2002 Round I EZ/EC Annual Report Assessment Process and 2002 Round II EZ Annual Report Assessment Process guidance states Community Planning and Development Representatives (Public Trust Officers) are responsible for assessing the progress made toward the implementation of the Empowerment Zones' Strategic Plan. The Fiscal Year 2002 Round I EZ/EC Annual Report Assessment Process guidance also states the Representatives must verify the five Implementation Plans with the largest budgets.

HUD's On-Site Monitoring Guidance for Field Offices for Round II Empowerment Zones, dated April 2002, states for each of the Round II Empowerment Zones, Field Office staff is to select six Implementation Plans for on-site reviews to verify the information provided in the Annual Reports.

HUD Did Not Adequately
Verify The Accuracy Of
Annual Reports

HUD's Community Planning and Development Field Offices did not adequately verify the accuracy of the June 2001 and/or the June 2002 Annual Reports for the six Empowerment Zones we examined. The six Zones were the Cities of Cincinnati; Cleveland; Huntington/Ironton; Minneapolis; Norfolk/Portsmouth; and St. Louis/East St. Louis.

A Community Planning and Development Representative at the Columbus Field Office performed on-site verification of six Implementation Plans in the City of Cincinnati's 2001 Annual Report. A Community Planning and Development Representative at the Columbus Field Office did not verify information for any of the Implementation Plans from the City of Cleveland's 2001 Annual Report. A Community Planning and Development Representative at the Pittsburgh Field Office performed on-site verification of only one Implementation Plan from the Cities of Huntington/Ironton's 2001 Annual Report. A Senior Community Planning and Development Representative at the Minneapolis Field Office performed on-site verifications of five Implementation Plans from the City of Minneapolis' 2001 Annual Report. However, none of the Representatives verified the Implementation Plans against supporting documentation. The Representatives relied on reports from the projects' administering entities or schedules showing the progress the projects were making.

The Community Planning and Development Representatives performed on-site verifications of Implementation Plans for the Cities' 2001 Annual Reports during August 2002. Again, the Representatives relied on reports from the projects' administering entities or schedules showing the progress the projects were making. Furthermore, the on-site verifications were conducted more than one year after the 2001 Annual Reports were due to HUD.

A Community Planning and Development Specialist with HUD's Headquarters Renewal Communities/Empowerment Zones/Enterprise Communities Initiative said the Community Planning and Development Representatives are to use the Annual Reports available to them at the time of their on-site reviews. However, none of HUD's Representatives verified the information for any of the

Implementation Plans in the Cities' June 2002 Annual Reports.

We identified that the Cities lacked adequate controls over their Annual Reports to accurately report to HUD. Of the 50 projects we reviewed from the June 30, 2001 and/or June 30, 2002 Annual Reports, the Cities inaccurately reported the outputs, milestones, and/or funding for 38. The status of the 12 remaining projects was correctly reported to HUD. The following table summarizes the most common inaccuracies reported by the six Zones for the 38 projects.

Empowerment Zone	Inaccurately Reported Information		
	Outputs	Milestones	Source(s) and/or Use(s) of Funds
Cincinnati	9	10	6
Cleveland	8	8	8
Huntington/Ironton	5	1	0
Minneapolis	5	1	1
Norfolk/Portsmouth	4	6	3
St. Louis/East St. Louis	<u>1</u>	<u>0</u>	<u>2</u>
Totals	<u>32</u>	<u>26</u>	<u>20</u>

Reported Outputs Were Inaccurate

The June 2001 and/or June 2002 Annual Reports for the six Empowerment Zones we reviewed contained inaccuracies regarding the outputs of 32 projects. Outputs are the results immediately created upon completion of a project. For example, the City of Minneapolis reported in its June 30, 2002 Annual Report that the Plymouth Christian Youth Center project created or retained seven Empowerment Zone resident jobs and served 500 Zone residents. Documentation maintained by Plymouth Christian Youth Center, the administering entity of the project, showed that two Zone resident jobs were created or retained and only 88 Zone residents were served as of June 30, 2002.

Reported Milestones Were Inaccurate

The June 2001 and/or June 2002 Annual Reports for the six Empowerment Zones we reviewed contained inaccuracies regarding the milestones of 26 projects. Milestones are the major steps taken to implement a project. For example, the City of Cincinnati inaccurately reported the actual progress for 11 milestones of the Nanny's Multi-Level Learning Center project in its June 30, 2001 Annual Report. The

following table shows the inaccuracies related to the project's 11 milestones.

<i>Project Milestone</i>	<i>Projected Start Date Reported</i>	<i>Was Projected Start Date Met As of 6/30/01?</i>	<i>Projected End Date Reported</i>	<i>Was Projected End Date Met As of 6/30/01?</i>	<i>Reported Percentage Complete as of 6/30/01</i>	<i>Actual Percentage Complete as of 6/30/01</i>
Begin construction/renovation of building converting it from medical building to a childcare center.	N/R	N/A	3/13/01	No	100	95
Advertising/promotion of events for the grand opening of the new childcare center.	2/2/01	No	4/26/01	No	100	0
Install kitchen equipment, computer systems, and cabinetry.	2/12/01	No	3/7/01	No	100	0
Begin enrolling new children.	2/13/01	No	3/13/01	No	100	0
Install fire system, security system, CCTV system and phone system.	2/26/01	No	3/7/01	No	100	0
Installation of children's playground equipment.	3/5/01	No	3/13/01	No	100	0
Inspection by the Health Department, building inspector, Fire Department and child daycare licensing.	3/13/01	No	3/20/01	No	100	0
Attain various childcare licenses and permits.	3/13/01	No	3/23/01	No	100	0
Opening for infants and toddlers.	3/23/01	No	3/23/01	No	100	0
Move center #1 (Rockdale facility) from old location to new location.	3/30/01	No	4/2/01	No	100	0
Move center #2 (Reading Road facility) to new location.	4/7/01	No	4/8/01	No	100	0
N/R-Not Reported; N/A-Not Applicable						

Reported Sources And/Or Uses Of Funds Were Inaccurate

The June 2001 and/or June 2002 Annual Reports for the six Empowerment Zones we reviewed contained inaccuracies regarding the sources and/or uses of funding for 20 projects. For example, the Cities of Norfolk/Portsmouth reported in their June 30, 2001 Annual Report that the Tower Mall project's sources of funding included \$12,000,000 from a major store scheduled to locate at the Tower Mall. Documentation maintained by the Cities as of June 30, 2001 showed that the store only invested \$2,750,000. The City of Portsmouth provided \$2,800,000 for the project. Therefore, the Cities overstated sources of funding for the Tower Mall project by \$6,450,000 (\$12,000,000 minus \$2,750,000 minus \$2,800,000).

Finding 2

HUD Lacked Adequate Procedures And Controls To Assess Zones

The inaccuracies in the June 2001 and/or June 2002 Annual Reports occurred because HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative lacked adequate procedures and controls to assess whether Empowerment Zones were making progress toward their Strategic Plans. HUD's guidance for the June 2001 Annual Reports for Round I and Round II Zones and the June 2002 Annual Reports for Round I Zones did not require Community Planning and Development Representatives to select projects in which results were reported. Furthermore, HUD's guidance for Round II Zones did not require Community Planning and Development Representatives to perform verification of the June 2002 Annual Reports for Round II Empowerment Zones. HUD also did not review the adequacy of the Representatives' verification reviews. Therefore, HUD did not have accurate information to assess the Zones' progress on meeting the goals of their Strategic Plans and the impression exists that the benefits of the Empowerment Zone Program were greater than actually achieved.

Auditee Comments

HUD's Office of Community Planning and Development did not provide written comments on our draft audit report.

Recommendation

We recommend that HUD's Assistant Secretary for Community Planning and Development assure that HUD's Office of Community Planning and Development:

- 2A. Implements procedures and controls to ensure that verifications of Annual Reports are conducted as required.

Management Controls

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Program Operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- 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.
- Compliance with Laws and Regulations - 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.

We assessed all of the relevant controls identified above during our audit of HUD's oversight of the Empowerment Zone Program.

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

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Program Operations

HUD's Office of Community Planning and Development did not sufficiently ensure that the Cities' Empowerment Zone Programs met their objectives. Specifically, the Office of Community Planning and Development: did not adequately confirm that Zones' projects complied with Federal requirements and the Zones' contracts with the projects' administering entities regarding the use of HUD funds; and lacked accurate information to assess the Zones' progress on meeting the goals of their Strategic Plans (see Findings 1 and 2).

- Validity and Reliability of Data

HUD's Office of Community Planning and Development did not adequately verify the accuracy of the June 2001 and/or 2002 Annual Reports submitted by the Cities for their Programs (see Finding 2).

- Compliance with Laws and Regulations

HUD's Office of Community Planning and Development did not follow its regulations regarding the assessments of Empowerment Zones and the verification of Annual Reports (see Finding 2).

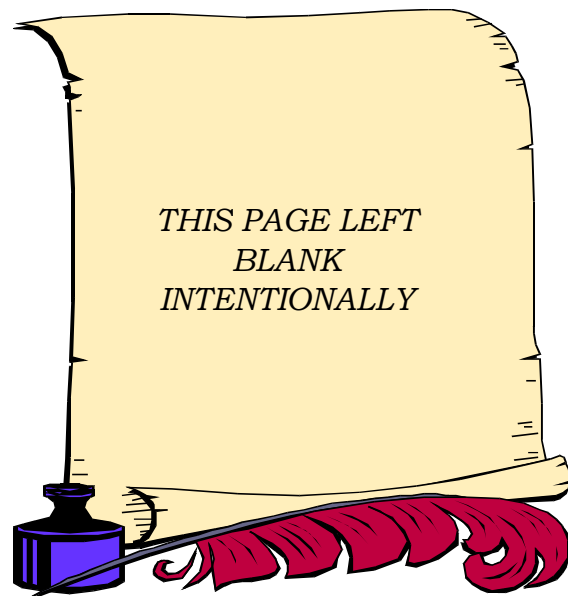
- Safeguarding Resources

HUD's Office of Community Planning and Development lacked adequate procedures and controls to verify that HUD funds were used according to Program guidelines (see Finding 1).

Follow Up On Prior Audits

HUD's Office of Inspector General issued a prior audit report (#99-CH-156-0001) regarding HUD's oversight of the Empowerment Zone Program on March 30, 1999. The audit report included two findings. The recommendations for the two findings were closed. Both of the findings are repeated in this report.

Audit Report #99-CH-156-0001	This Report
HUD's Controls For Assessing Empowerment Zones Were Not Adequate	Controls Over HUD Funds Were Not Adequate
HUD Did Not Verify The Accuracy Of Performance Review Submitted By The Cities	HUD Did Not Adequately Verify Annual Reports Submitted By The Cities



Empowerment Zones Reviewed

This appendix contains the projects reviewed at the six Empowerment Zones we audited and a summary of our findings for each Zone. The six Zones were: Cincinnati, Ohio; Cleveland, Ohio; Huntington, West Virginia/Ironton, Ohio; Minneapolis, Minnesota; Norfolk/Portsmouth, Virginia; and St. Louis, Missouri/East St. Louis, Illinois. We selected 65 of the Zones 217 contracts for projects reported in the Zones' June 30, 2001 and/or June 30, 2002 Annual Reports. We found that the Zones inappropriately used or lacked documentation to support the use of HUD (Empowerment Zone, Section 108 Loan Guarantee, and Economic Development Initiative Grant) funds, and inaccurately reported the accomplishments of their Programs to HUD for 38 of the 50 projects we reviewed.

City Of Cincinnati's Empowerment Zone

The City of Cincinnati, Ohio needs to improve its oversight of Zone funds. Four of the 10 projects we reviewed incurred inappropriate or unsupported expenditures of Zone funds. The City inappropriately used \$15,364 of Zone funds and lacked documentation to show that another \$311,346 in Zone funds paid benefited the City's Empowerment Zone Program or were matched with in-kind services as required.

The City inaccurately reported the actual status and/or progress for all 10 of the projects we reviewed from its June 30, 2001 or June 30, 2002 Annual Reports. The City's June 2001 Report contained inaccuracies related to two projects' progress on projected outputs, three projects' milestones, and one project's source of funding. The City's June 2002 Report inaccurately showed seven projects' progress on projected outputs, seven projects' milestones, and five projects' sources of funding.

The City used \$594,462 of the \$648,030 in Zone monies committed to fund three projects that have not benefited Zone residents or benefited only 37 percent of Zone residents as of October 2002. The three projects were completed between August 2001 and November 2002. Since the three projects spent 92 percent of their funds committed, benefits to Zone residents would be expected. However, this has not occurred.

Based upon the projects' reported expenditures as of April 30, 2002, we selected 10 of the City's 28 projects reported in its June 30, 2001 or June 30, 2002 Annual Reports. The following table shows the 10 projects reviewed.

<i>Project</i>
1. Enhanced School Health
2. Arts for All
3. Youth Capacity and Resource Building/Coalition Freedom School
4. Walnut
5. Nu-Blend Paints, Inc.
6. Liberty Street Learning Center
7. People Working Cooperatively
8. Nanny's Multi-Level Learning Center
9. A.D.A. Investment Group, Inc.
10. Big Dollar, LLC

City Of Cleveland's Empowerment Zone

The City of Cleveland, Ohio failed to maintain sufficient oversight of its HUD (Section 108 Loan Guarantee and Economic Development Initiative Grant) funds for its Program. All 10 of the projects we reviewed incurred inappropriate or unsupported expenditures of HUD funds for its Program. The City inappropriately used \$6,891,245 of HUD funds that did not benefit the City's Program or were not matched with in-kind contributions. The City also lacked documentation to support that another \$4,744,824 in HUD funds paid benefited the City's Program. As of November 2002, the City spent \$22,015,883 of HUD funds on the 10 projects.

The City of Cleveland inaccurately reported the actual status and/or progress for eight of the 10 (80 percent) projects we reviewed from its June 30, 2001 Annual Report. The City's June 2001 Annual Report contained inaccuracies related to the eight projects' progress on projected outputs, milestones, and sources and/or uses of Program funds.

The City of Cleveland used \$13,207,000 of the \$13,730,000 in HUD monies committed to fund three projects that have not provided benefits to Zone residents or benefited only 25 percent of Zone residents as of November 2002. The three projects are scheduled for completion in December 2004. Since the three projects spent 96 percent of their HUD funds committed, benefits to Zone residents would be expected. However, this has not occurred.

The City of Cleveland did not follow its Economic Development Initiative Grant Agreement with HUD, effective May 17, 1996, and its February 7, 1996 contract

with Fairfax Renaissance Development Corporation to ensure that Program income was remitted to the City and deposited into its loan repayment account. The account was established by the City as security for the repayment of the Section 108 Loan Guarantee. Fairfax Renaissance Development Corporation is fully funded with Economic Development Initiative Grant and Community Development Block Grant funds. Fairfax receives fees for development services it performs. Fairfax received \$1,162,263 in development fees between 1996 and 2002.

Based upon the projects' reported expenditures as of April 30, 2002, we selected 10 of the City's 88 contracts for projects reported in its June 30, 2001 Annual Report. The following table shows the 10 projects we reviewed.

<i>Project</i>
1. Glenville Town Center, Ltd.
2. Quincy Place
3. Midtown Corporate Center
4. Lassi Enterprises, L.L.C.
5. Empowerment Zone Commercial Security
6. Fairfax Renaissance Development Corporation Operating
7. Hough Area Partners In Progress Operating
8. Vocational Guidance Services' Job Match
9. Center for Employment and Training – Cleveland, Inc.
10. IMR Global – Orion Consulting, Inc. And The Reserve Network Bank Teller Job Training

Cities Of
Huntington/Ironton's
Empowerment Zone

The Cities of Huntington, West Virginia/Ironton, Ohio need to improve their oversight of Zone funds. One of the 10 projects we reviewed inappropriately used \$160,000 of Zone funds to serve non-Zone residents. Since the Cities spent over \$4.6 million in Zone funds as of April 2002 for the 10 projects, the Cities' inappropriate use of Zone funds was not a systematic break down in their oversight of the Program. However, the Cities' Strategic Plan for the Marting Hotel Renovation project showed that low to moderate income, elderly households residing in the Zone would be the targeted group to occupy the project. This was not done. Additionally, the September 8, 1999 Agreement for the project showed that 50 Zone residents expected to be served.

However, Zone residents have only occupied 10 of the 50 units as of November 2002.

The Cities incorrectly reported the actual status and/or progress for five of the 10 projects we reviewed from their June 30, 2001 or June 30, 2002 Annual Reports. The Cities' June 2001 Report contained inaccuracies related to five projects' progress on projected outputs and one project's percentage of completion on a project milestone.

The Cities of Huntington and Ironton used \$4,035,697 of the \$4,637,000 in Zone monies committed to fund five projects that have not provided benefits to Zone residents or benefited only 27 percent of Zone residents as of October 2002. Four of the five projects are scheduled for completion between June 2004 and June 2005, and the remaining project was completed in June 2001. Since the four projects spent 87 percent of their Zone funds committed, benefits to Zone residents would be expected. However, this has not occurred.

Based upon the projects' reported expenditures as of April 30, 2002, we selected 10 of the Cities' 29 projects reported in their June 30, 2001 or June 30, 2002 Annual Reports. The following table shows the 10 projects reviewed.

<i>Project</i>
1. Marting Hotel Renovations
2. American College Testing Work Keys
3. School Based Behavioral Health Services
4. Universal Screening
5. Huntington Industrial Center
6. South Point
7. Douglass Building Renovations
8. City of Huntington Street Improvements
9. City of Huntington Infrastructure
10. City of Ironton Street Improvements

City Of Minneapolis' Empowerment Zone

The City of Minneapolis, Minnesota incorrectly reported the actual status and/or progress for seven of the 10 projects (70 percent) we reviewed from its June 30, 2001 or June 30, 2002 Annual Reports. The City's June 2001 Report contained inaccuracies related to three projects' progress on projected outputs and one project's percentage of completion on project milestones. The City's June 2002 Report

contained inaccuracies related to two projects' progress on projected outputs and one project's source of funding.

The City used all of its \$1,825,000 in Zone monies committed to fund seven projects that have not benefited Zone residents or benefited only 3 to 38 percent of Zone residents as of June 2002. Five of the seven projects are scheduled for completion between December 2003 and December 2011, and the remaining two projects were completed between December 2001 and July 2002. Since the five projects spent all of their Zone funds committed, benefits to Zone residents would be expected. However, this has not occurred.

The City needs to improve its oversight of Empowerment Zone funds. One of the 10 projects we reviewed inappropriately used \$9,705 of Zone funds to pay expenses not related to the Near North Planning and Development project. Since the City spent over \$3.6 million in Empowerment Zone funds as of May 2002 for the 10 projects, the City's inappropriate use of Zone funds was not a systematic break down in its controls over the Program.

Based upon the projects' reported expenditures as of April 30, 2002, we selected 10 of the City's 20 projects reported in its June 30, 2001 or June 30, 2002 Annual Reports. The following table shows the 10 projects reviewed.

<i>Project</i>
1. Plymouth Christian Youth Center
2. Minneapolis Public School Wireless Technology
3. Agape 24-Hour Child Development Center
4. Green Institute
5. Near North Phase 1B
6. Park Plaza
7. Near North Planning and Development
8. Coliseum
9. Hawthorne Homesteading
10. Opportunity Kitchen

Cities Of
Norfolk/Portsmouth's
Empowerment Zone

The Cities of Norfolk/Portsmouth, Virginia failed to maintain adequate controls over their Zone funds. Seven of the 18 projects we reviewed incurred inappropriate or unsupported expenditures of Zone funds. Specifically, the City obtained \$293,772 from HUD for activities without

approved Implementation Plans and paid \$100,332 for items or services that were either unallowable or unsupported. The Cities took immediate corrective action and obtained the required HUD approved Implementation Plan for \$61,950 of the \$293,772 after being informed of the issue. The Cities also did not properly allocate indirect costs totaling \$249,342 among activities benefiting from the funding.

The Cities of Norfolk and Portsmouth inaccurately reported the actual status and/or progress for all six of the projects we reviewed from its June 30, 2001 Annual Report. The Cities' June 2001 Report contained inaccuracies related to four projects' progress on projected outputs, all six projects' percentage of completion on project milestones, and three projects' source of funding.

Based upon the projects' reported expenditures as of June 30, 2002, we selected 18 of the Cities 32 projects that received funding to determine whether the Cities efficiently and effectively used Zone funds. To determine whether the Cities accurately reported the accomplishments of their Program, we reviewed all six activities reported in their June 2001 Annual Report. The following table shows the 21 projects reviewed.

<i>Project</i>
1. Formation And Administration Of E-2010 Corporation
2. Mobile Empowerment Center
3. Empowerment Center/Portsmouth *
4. Empowerment 2010 Works
5. Access To Jobs
6. College Bound Scholarship
7. Child Care Programs
8. Second Chances Programs
9. Training Stipends
10. MEDAL Loan Loss Reserve
11. Small Business Resource Center
12. Tower Mall
13. Park Place East
14. Central Brambleton
15. New Electrical Substation In Support of HOPE VI
16. Anne/Outten Street Development
17. Brewery Site Development
18. Norfolk EZ/HOPE VI Community And Support Services
19. Neighborhood Development *
20. Administration Office And Empowerment Center/Norfolk
21. Tuition Voucher Fund *
* Project's disbursements not reviewed.

Cities Of St. Louis/East St. Louis' Empowerment Zone

The Cities of St. Louis, Missouri/East St. Louis, Illinois inaccurately reported the actual status and/or progress for two of the four (50 percent) projects we reviewed from its June 30, 2002 Annual Report. The City's June 2002 Annual Report contained inaccuracies related to the one project's progress on projected outputs and two projects' sources of funding.

Based upon the projects' reported expenditures as of July 10, 2002, we selected four of the City's 20 contracts that received funding. The following table shows the four projects we reviewed.

<i>Project</i>
1. Person's Place Phase 1
2. Near Southside Hope Senior Housing
3. Midwest Telecommunications Preparatory Academy
4. River South Recreation Area Remediation