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TO: Nelson R. Bregon
General Deputy Assistant Secretary for Community Planning and Development, D

FROM: D. Michael Beard
Regional Inspector General for Audit, 6AGA

SUBJECT: Audit of Management Controls over Grantee and Subgrantee Capacity
Community Planning and Development
Washington, D.C.

In response to a Congressional inquiry, we reviewed how Community Planning and Development (CPD) ensures grantees and subgrantees have sufficient capacity to successfully participate in its programs. The Congressional inquiry related specifically to the program capacity of nonprofit organizations. However, CPD does not have management controls unique to nonprofits; therefore, it was necessary for us to assess controls over all grantees and subgrantees.¹

Our report contains two findings with recommendations requiring action by your office and one issue needing further study or consideration. 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.

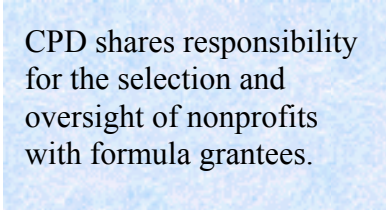
Should you or your staff have any questions, please contact Theresa Carroll, Assistant Regional Inspector General for Audit, or me, at (817) 978-9309.

¹ For purposes of this report, we used the term *grantee* to represent all entities that receive funds directly from CPD. We used the term *subgrantee* to represent all entities that receive CPD funding through a grantee.



Executive Summary

We have completed an audit of Community Planning and Development's (CPD's) management controls over the capacity of entities participating in CPD's programs. Specifically, we looked at CPD's management controls over selection and oversight of grantees and subgrantees. We conducted the audit based on a Congressional inquiry related specifically to the management controls over nonprofits. However, since CPD does not have management controls unique to nonprofits, it was necessary for us to assess the management controls over all grantees and subgrantees. For purposes of this report, we used the term *grantee* to represent all entities that receive funds directly from CPD. We used the term *subgrantee* to represent all entities that receive CPD funding through a grantee.



CPD shares responsibility for the selection and oversight of nonprofits with formula grantees.

CPD shares responsibility for evaluating the capacity of nonprofits with grantees. Unlike other HUD programs, CPD does not pre-approve nonprofits to participate in its programs. For formula programs, nonprofits can only participate as subgrantees. In these instances, the grantee is responsible for ensuring any nonprofits they select for funding have sufficient capacity to carry out grant activities. For most of CPD's competitive programs,² CPD allows nonprofits to compete directly for funding along side government and for-profit organizations. CPD assesses the capacity of nonprofits as part of the selection process based on program specific criteria. Accordingly, for CPD Programs, either a formula grantee or CPD should assess nonprofit capacity at the time of funding.

CPD also shares oversight responsibility of nonprofits with formula grantees. CPD oversight consists primarily of approving grantee applications; budgets and grant agreements; reviewing grantee annual financial and performance reports; and conducting on-site and remote monitoring of grantees. CPD also provides group training or direct technical assistance to grantees as needed. CPD holds formula grantees responsible for selecting and providing adequate oversight of their nonprofit subgrantees. However, when CPD provides direct funding to nonprofits, CPD has sole oversight responsibility.

² Nonprofits were eligible applicants in five of the seven competitive programs we reviewed. Nonprofits were not eligible to compete for Brownfield Economic Development Initiative (BEDI) or Shelter Plus Care funding (S+C) but are eligible to participate as subgrantees.

CPD's management controls do not provide adequate protection against funding grantees lacking capacity.

CPD's management controls are not sufficient to provide reasonable assurance that only grantees and subgrantees with capacity participate in its programs. CPD has controls to minimize the risk that grantees and subgrantees lacking capacity receive CPD program funding. However, unverified assumptions, incomplete and outdated guidance, and limited on-site monitoring undermine these controls. For formula grantees, CPD operates on the assumption grantees are capable of administering the programs and holds them accountable for ensuring any subgrantees also have capacity. CPD cannot demonstrate prior to funding that grantees have sufficient capacity or that grantees are fully evaluating the capacity of their subgrantees.

For competitive grants, CPD incorporates capacity into the Notice of Fund Availability (NOFA) as both a threshold factor and a rating factor. However, if the applicant is new or CPD has not monitored the applicant on-site, CPD accepts without verification that the application accurately reflects the applicant's capacity. Further, for some competitive grants, CPD set the threshold factor too low to be effective and excluded field office staff, who should be the most familiar with the grantees, from the selection process. As a result, CPD cannot be reasonably assured that it only funds grantees and subgrantees capable of effectively carrying out its programs in accordance with applicable laws and regulations. CPD needs to provide guidance for grantees to use to evaluate the capacity of their subgrantees. Further, CPD should include field office personnel in the selection process for its competitive grants and set capacity thresholds at a meaningful level.

CPD needs to improve management controls over monitoring.

CPD bases its monitoring goals and grantee risk analyses on unverified assumptions. CPD has never evaluated the aggregate risk associated with its programs or made a decision as to what level of risk is acceptable. Further, CPD has not tested its grantee risk analysis process to ensure it accurately identifies the highest risk grantees. As a result, CPD lacks assurance that it has the resources to perform the appropriate level of monitoring. Additionally, CPD cannot demonstrate that it is focusing limited resources on the highest risk programs and grantees. CPD needs to evaluate program risk and test and adjust its procedures as necessary to provide for effective monitoring.

CPD needs technical assistance funding for CDBG.

CPD should give additional consideration for efforts to obtain technical assistance funds for CDBG. CPD can use technical assistance funds to increase grantee capacity through training and the provision of web resources, guidebooks, and other resources. However, Congress has not appropriated technical assistance funds for CDBG, CPD's largest program, since fiscal year 1999. CPD does not know why Congress continues to decline providing funding. The lack of technical assistance funding prevents CPD from developing the types of resources other CPD programs have for increasing capacity. CPD should consider contacting Congressional officials to determine why Congress denied funding to CDBG and whether Congressional concerns can be addressed. CPD should also consider providing a more specific description of CDBG grantee needs and how those grantees could use technical assistance funds to meet those needs in future budget requests.

Auditee Comments

We provided a discussion draft to CPD officials on October 27, 2003, and scheduled an exit conference for November 14, 2003. At CPD's request, we twice postponed the exit conference that was eventually held on December 3, 2003. We made revisions to the report based upon CPD's comments, and provided CPD with the final draft on January 12, 2004. We requested CPD provide their written comments by January 30, 2004. After two requests for additional time, CPD provided their comments on February 11, 2004, under the signature of the General Deputy Assistant Secretary for CPD. The General Deputy stated the report was flawed and requested that it be withdrawn. Accordingly, the OIG subjected the report to additional review before issuance. The General Deputy's comments and the OIG's evaluation of those comments are provided in Appendix E.

Recommendations

We recommend that CPD provide guidance for grantees to evaluate capacity, involve field office personnel in decisions where appropriate, and increase minimum threshold requirements for capacity for competitive grant programs. Further, we recommend that CPD document the basis for establishing monitoring goals, evaluate risks, test its risk assessment process, schedule monitoring based on risks, increase training for field staff responsible for

monitoring, and provide field offices with appropriate financial analyst capability.

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Abbreviations

ACA	Annual Community Assessment
APR	Annual Performance Report
BEDI	Brownfields Economic Development Initiative
CAPER	Consolidated Annual Performance and Evaluation Report
CDBG	Community Development Block Grants
CFO	Chief Financial Officer
CHDO	Community Housing Development Organization
CPD	Community Planning and Development
DHCD	Department of Housing and Community Development
ESG	Emergency Shelter Grant
FTE	Full-Time Equivalent
GAO	U.S. General Accounting Office
GMP	Grants Management Process system
HIPRS	HUD Integrated Performance Reporting System
HOME	HOME Investment Partnership Program
HOPWA	Housing Opportunities for Persons with Aids
HUD	U.S. Department of Housing and Urban Development
IDIS	Integrated Disbursement and Information System
NAPA	National Academy of Public Administration
NOFA	Notice of Funding Availability
OFM	Office of Field Management
OIG	Office of Inspector General
QMR	Quality Management Review
REAP	Resource Estimation Allocation Process
RHED	Rural Housing and Economic Development
S+C	Shelter Plus Care
SHP	Supportive Housing Program
SNAPS	Special Needs Assistance Programs (Continuum of Care and ESG)
SRO	Single Room Occupancy
YB	Youthbuild

Introduction

Background

The Office of Community Planning and Development's (CPD's) mission is to develop viable communities by supporting integrated approaches to the provision of decent housing, suitable living environments, and expanded economic opportunities for low- and moderate-income persons. CPD works in partnership with all levels of government and the private sector, including for-profit and nonprofit organizations. In fiscal year 2003, CPD administered 22 programs and initiatives in support of its mission (see Appendix A).

Congress appropriated over \$8 billion for CPD programs in fiscal year 2003. CPD programs account for over 25 percent of HUD's overall budget and are integral to HUD's efforts in meeting its strategic goals. Accordingly, the efficiency and effectiveness of CPD programs has a significant impact on HUD's ability to meet its mission of increasing homeownership, supporting community development, and increasing access to affordable housing free from discrimination. CPD's management controls are essential to program efficiency and effectiveness.

CPD programs can generally be divided into three categories: formula programs, competitive homeless programs, and competitive non-homeless programs. Formula programs provide funding on a noncompetitive basis to cities, states, and qualified urban areas meeting certain population and need-based thresholds. With the exception of the State Administered CDBG program, formula grantees may carry out activities themselves or provide funding to a contractor or subgrantee to perform the work.³ The competitive homeless programs are also known as the Continuum of Care programs. Through the Continuum of Care Notice of Funding Availability (NOFA), CPD encourages continuums⁴ to develop comprehensive and coordinated housing and service delivery systems for the homeless. Applicants must apply for funding through their local continuum in order to have a realistic chance of receiving funding. The competitive non-homeless programs are composed of all the competitive

³ Under the state administered CDBG program, states administer CDBG funds on behalf of HUD. States must provide the funding to cities that are not qualified to receive CDBG funds directly from HUD.

⁴ A continuum is an organization of local individuals and entities interested in serving the homeless. CPD does not have any regulations governing the operation or organization of the continuums.

grants other than the homeless grants. The competitive grantees may also use contractors or subgrantees, but they must identify them in their application.

The following is a list of CPD programs, by category, for which Congress appropriated \$25 million or more in fiscal year 2002.⁵ It includes all the formula and homeless programs and three competitive non-homeless programs.

Program	Authorization/ Regulation	Fiscal Year 2004 Appropriation
Formula Programs		
The CDBG 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.	Title 1 of the Housing and Community Development Act of 1974, Public Law 93-383, as amended, 42 U.S.C.-5301 et seq. 24 CFR 570	\$4,356,550,000
The HOME Investment Partnership Program (HOME) provides annual grants on a formula basis to eligible state and local governments to strengthen public-private partnerships and to expand the supply of decent, safe, sanitary, and affordable housing, with primary attention to rental housing, for very low-income and low-income families.	HOME Investment Partnerships Act at Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended, 42 U.S.C. 12701 et seq. 24 CFR 92	\$1,930,000,000
The Housing Opportunities for Persons with AIDS (HOPWA) program provides states and localities with the resources and incentives to devise long-term comprehensive strategies for meeting the housing and related supportive service needs of persons with HIV/AIDS and their families. ⁶	The AIDS Housing Opportunity Act (42 U.S.C. 12901). 24 CFR 574	\$296,500,000
The Emergency Shelter Grant (ESG) program is the first step in a continuum of assistance to enable homeless individuals and families to move toward independent living as well as to prevent homelessness. The program funds emergency shelters and homeless prevention activities.	Subtitle B of title IV of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11371-11378). 24 CFR 576	\$159,056,000

⁵ The listing excludes directed grants, grants Congress appropriates to specific entities, and grant programs administered outside of CPD.

⁶ HUD sets aside 10 percent of HOPWA funds to be provided on a competitive basis for special projects of national significance and other projects that do not qualify for formula grants.

Competitive Homeless Programs		
The Supportive Housing Program (SHP) promotes the development of supportive housing and supportive services including innovative approaches to assist homeless persons in the transition from homelessness and to promote the provision of supportive housing to homeless persons to enable them to live as independently as possible.	Title IV of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11381-11389). 24 CFR 583	\$1,100,469,000 For all Competitive Homeless Programs
Shelter Plus Care (S+C) links rental assistance to supportive services for hard-to-serve homeless persons with disabilities (primarily those who are seriously mentally ill; have chronic problems with alcohol, drugs, or both; or have acquired immunodeficiency syndrome (AIDS) and related diseases) and their families.	Title IV, Subtitle F, of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11403-11407b). 24 CFR 582	
The Single Room Occupancy (SRO) program provides rental assistance for homeless individuals in rehabilitated housing units.	Section 441 of the McKinney-Vento Homeless Assistance Act. 24 CFR 882	
Competitive Non-Homeless Programs		
The Rural Housing and Economic Development (RHED) program builds capacity at the State and local level for rural housing and economic development and supports innovative housing and economic development activities in rural areas.	Departments of Veteran's Affairs, Housing and Urban Development and Independent Agencies Appropriations Act of 1999 (Pub. L. 105-276). No Regulations	\$25,000,000
Youthbuild provides grants to nonprofit organizations to assist high-risk youth between the ages of 16-24 to learn housing construction job skills and to complete their high school education.	Subtitle D of Title IV of the National Affordable Housing Act (the Act), added through Section 164 of the Housing and Community Development Act of 1992 (Pub. L. 102-550, 106 STAT. 3723, 42 U.S.C. 12899). 24 CFR 585	\$65,000,000
The Brownfields Economic Development Initiative (BEDI) assists public entities in the redevelopment of brownfields and enhances the security or improves the viability of projects financed with Section 108 guaranteed loan authority.	Section 108(q) of the Housing and Community Development Act of 1974, as amended. No Regulations	\$25,000,000

Audit Objective

We initiated this audit based on a Congressional inquiry concerning the manner in which HUD controls participation of nonprofit entities in its programs, particularly with respect to ensuring that such entities possess the necessary capacity. Following a preliminary

assessment and considering prior audit coverage, OIG added an assignment to the fiscal year 2003 audit plan to evaluate HUD's procedures for approving nonprofits to participate in CPD programs and to determine whether the selection and oversight processes adequately considered capacity.

Our initial audit objective was to determine whether CPD's management controls were sufficient to provide reasonable assurance that participating nonprofits have the capacity to carry out grant activities. However, since CPD does not have management controls unique to nonprofits as opposed to other program participants, it was necessary for us to evaluate management controls over all grantees and subgrantees. Our objective included evaluating the management controls over both the selection and oversight of grantees and subgrantees.

CPD does not define capacity for its formula grant programs even though enabling legislation for those programs refer to capacity in relation to funding grantees. For competitive grant programs, CPD does not have a single definition of capacity. In evaluating capacity for its competitive programs, CPD primarily focuses on applicants' relevant experience, past performance and organizational structure. For purposes of this report, we considered capacity as the ability of an entity to demonstrate that it has:

- the organizational resources necessary to successfully implement the grant activities in a timely manner,
- experience in carrying out activities similar to those provided for in the grant, and
- systems to properly account for the grant funds.



Audit Scope and
Methodology

We conducted fieldwork at HUD Headquarters and the Fort Worth CPD field office between October 2002 and August 2003. To obtain an understanding of CPD's management controls, we performed the following:

- Interviewed CPD officials from the following offices:
 - Office of the Deputy Assistant Secretary for Operations
 - Office of Technical Assistance and Management

- Office of Field Management
- Office of Block Grant Assistance
- Office of Affordable Housing Programs
- Office of the Deputy Assistant Secretary for Economic Development
- Office of HIV/AIDS
- Fort Worth CPD Office;
- Interviewed HUD officials from the Office of the Assistant Chief Financial Officer for Budget;
- Reviewed fiscal year 2002 Financial Audit Review workpapers on CPD field office monitoring of grantees and the Office of Field Management's (OFM's) monitoring of the field offices;
- Evaluated the system capabilities of the Integrated Disbursement and Information System (IDIS) and Grants Management Process (GMP) systems;
- Analyzed monitoring data in the GMP system;
- Reviewed audit work performed on the IDIS as part of the FY 2002 Financial Audit Review;
- Reviewed Government Accounting Office (GAO) and Office of Inspector General (OIG) reports on HUD's human resource management;
- Reviewed HUD's Resource Estimation and Allocation Process (REAP) reports; and
- Reviewed HUD's Corrective Action Plan submitted to Congress to address its Full Time Equivalent (FTE) level.

We also performed a review of management controls over ten CPD programs that met the following criteria:

- 1) Congress appropriated at least \$25 million for new grantees in FY 2002;
- 2) Nonprofits operate within the program;
- 3) CPD administers the program; and
- 4) The program is not a directed grant or grant for which Congress appropriates money for a specific entity.

These ten programs accounted for 92 percent of CPD's total budget for fiscal year 2002. For these programs we evaluated applicable regulations, handbooks, notices, grant agreements, NOFAs, training material, information on the HUD web, and other HUD guidance.⁷

⁷ See the Background section for a listing of the specific programs reviewed.

Our review generally covered fiscal years 2001 through 2003. We obtained an understanding and assessed the general sufficiency of CPD's management controls, but we did not perform field tests of the controls. Further, CPD's Office of Technical Assistance and Management provided the following data: (1) number of CPD programs; (2) number of grants and grantees; (3) FTE levels; (4) number of new employees; (5) field offices without financial analysts; (6) travel dollars; and (7) training courses provided. CPD obtained the data from computerized and paper sources. We did not assess the reliability of the data because it was not necessary to answer the audit objectives. We conducted our audit in accordance with generally accepted government auditing standards.

CPD's Management Controls Do Not Provide Adequate Protection Against Funding Grantees Lacking Capacity

CPD's management controls are not sufficient to provide reasonable assurance that only grantees and subgrantees with capacity participate in its programs. CPD has controls to minimize the risk that grantees and subgrantees lacking capacity receive CPD program funding. However, unverified assumptions, incomplete and outdated guidance, and limited on-site monitoring undermine these controls. For formula grantees, CPD operates on the assumption grantees are capable of administering the programs and holds them accountable for ensuring any nonprofits they fund also have capacity. CPD cannot demonstrate prior to funding that grantees have sufficient capacity or that grantees are fully evaluating the capacity of their subgrantees. For competitive grants, CPD incorporates capacity into the NOFA as both a threshold factor and a rating factor. However, if the applicant is new or CPD has not monitored the applicant on-site, CPD accepts without verification that the application accurately reflects the applicant's capacity. Further, for some competitive grants CPD set the threshold factor too low to be effective and excluded field office staff, who should be the most familiar with the grantees, from the selection process. As a result, CPD cannot be reasonably assured that it only funds grantees and subgrantees capable of effectively carrying out its programs in accordance with applicable laws and regulations.

OMB Circular No. A-123 defines management controls.

Office of Management and Budget Circular No. A-123, Section II, states:

“Management controls are the organization, policies, and procedures used by agencies to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported, and used for decision making.

Management controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include processes for planning, organizing, directing, and controlling program operations. A subset of management controls are the internal controls used to assure that there is prevention

or timely detection of unauthorized acquisition, use, or disposition of the entity’s assets.”

CPD management is responsible for ensuring the adequacy of management controls.

HUD Handbook 1840.1, Rev-3, dated February 1999 provides HUD managers with policies, procedures, and guidance for carrying out an effective management control process within HUD. Paragraph 3-2 states:

“All levels of management are responsible for ensuring the adequacy of controls. Managers must plan and conduct ongoing evaluations of management controls to:

- Ensure that the controls remain effective and efficient, and function as intended and
- Identify management controls that need to be strengthened or streamlined.”

Capacity is not a factor used to allocate formula grants.

CPD’s formula programs provide funding on a noncompetitive basis to cities, states, and qualified urban areas meeting certain population and need-based thresholds. CPD’s regulations do not require grantees to demonstrate capacity in any way as a prerequisite to funding. Instead, the regulations effectively dictate that CPD operate on the assumption that grantees have capacity unless the grantees prove otherwise. Applicable legislation is ambiguous concerning whether Congress intended HUD to consider capacity in funding formula grantees.⁸

Although it is reasonable to assume cities and states have at least some capacity, the actual capacity of grantees varies. In fact, our prior audits have demonstrated that some city

⁸ Although the formulas do not consider capacity, other sections of the United States Code specifically refer to capacity in relation to funding formula grantees:

- Title 42 U.S.C., Section 5304(e) requires HUD to evaluate a CDBG grantee’s current performance and empowers HUD to adjust grant amounts based among other things on a grantee’s “continuing capacity to carry out activities in a timely manner.”
- Title 42 U.S.C., Section 12746(3) only allows states or units of local government with a HOME allocation of less than \$750,000 to receive funding if the Secretary finds that the jurisdiction has demonstrated a capacity to carry out grant activities.
- Title 42 U.S.C., Section 12905(b) states the “capacity and capability to effectively administer a [HOPWA] grant” is a precondition to receiving funding. However, HUD’s regulation implementing Section 12905 only extends the responsibility for evaluating capacity to states and cities receiving HOPWA allocations. The regulation, 24 C.F.R. 574.410, does not require HUD to engage in a similar analysis of states and cities.

and state grantees lack sufficient capacity. For example, the District of Columbia OIG's audit of the Department of Housing and Community Development's (DHCD's) use of CDBG funds found that DHCD did not effectively manage its resources, did not effectively monitor the progress of subgrantees, and could not provide supporting documentation for over \$11 million in expenditures. A HUD OIG audit of the City of Atlanta's administration of the Section 108 and EDI grants for the Historic Westside Village project identified serious deficiencies with the city's and its subrecipient's management of the project. The audit recommended HUD require the city to provide evidence that its management control and accounting systems comply with HUD requirements. It further recommended HUD to require the city to repay \$1.65 million of non-competitively procured services and ineligible and unsupported costs. A recent HUD OIG audit of the Puerto Rico Department of Housing's HOME grants concluded that the department's accounting system was so poor the grants were unauditible. The audit identified \$1,687,484 in ineligible costs and \$627,015 in unsupported costs.

CPD has the option of terminating funding for grantees shown to lack capacity.

Federal regulations for all of the formula grants provide CPD with the option of terminating funding to grantees for a lack of compliance with program regulations. Accordingly, CPD is not obligated to continue to fund grantees that have demonstrated a lack of capacity. Still, CPD has never terminated funding to a formula grantee. CPD officials believe capacity issues can be better addressed by working with grantees than by terminating their funding. CPD officials also expressed the desire to avoid harming intended beneficiaries of their programs.

CPD holds formula grantees responsible for subgrantees but has not provided complete and up to date guidance.

Formula grantees have the option of administering their own programs, procuring contractors, or using subgrantees. Regardless of how a formula grantee chooses to administer its program, CPD holds the grantee strictly responsible for ensuring funds are spent in accordance with program requirements.

- **CDBG - 24 CFR 570.501 (b)** The recipient (i.e. grantee) is responsible for ensuring that CDBG funds are used in accordance with all program requirements. The use of designated public agencies, subrecipients, or

contractors does not relieve the recipient of this responsibility.

- **HOME - 24 CFR 92.504(a)** The participating jurisdiction (i.e. grantee) is responsible for managing the day-to-day operations of its HOME program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate action when performance problems arise. The use of state recipients, subrecipients, or contractors does not relieve the participating jurisdiction of this responsibility.
- **ESG - 24 CFR 576.61** Grantees are responsible for ensuring that ESG amounts are administered in accordance with federal regulations and other applicable laws. Grantees are also responsible for compliance by its recipients.
- **HOPWA - 24 CFR 574.500(a)** Grantees are responsible for ensuring that grants are administered in accordance with the requirements of this part and other applicable laws. Grantees are responsible for ensuring that their respective project sponsors carry out activities in compliance with all applicable requirements.

Although CPD holds grantees liable for ensuring any subgrantees they use have capacity, CPD's guidelines for grantees to use in evaluating capacity cover the CDBG program only. That guidance, a publication titled, *Managing CDBG: A Guidebook for Entitlement Grantees on Subrecipient Oversight*, contains a bulleted list of questions that should be asked when assessing a subrecipient's overall organizational capacity. It also includes five models for performing pre-award assessments and selecting subrecipients. However, the guidebook is outdated.⁹ CPD has a training course for the HOME program that discusses capacity, *HOME Base: Building and Supporting Your Programs with Nonprofits*, but it relates to Community Housing Development Organizations (CHDOs) only. CPD officials did not think it was feasible to develop any one definition for capacity noting that

⁹ At the exit conference the CPD DAS for Operations said they planned to issue a revised guidebook in April 2004. However, CPD officials now estimate that the guidebook will not be issued before the end of July 2004.

sufficient capacity varies by the project to be performed. However, this does not preclude CPD from developing guidance for grantees to consider when evaluating subgrantees.

In evaluating applicants for competitive grants, CPD's consideration of capacity varies, depending on the program.

CPD awards competitive grants through Notices of Funding Availability (NOFA). The NOFAs generally define capacity as the ability to carry out the proposed project successfully. CPD included capacity as a threshold factor,¹⁰ rating factor or both for all the competitive programs we reviewed, except for new HOPWA projects. As a rating factor, CPD established capacity as a significant portion of the applicants' overall score, anywhere from 15 to 25 percent. In evaluating capacity, CPD looked at the capacity of any proposed subgrantees, contractors, or consultants as well as the capacity of the applicant.

Fiscal Year 2002 Threshold and Rating Factors

Program	Threshold Factor (Yes/No)	Rating Factor (Percent of Score)
Continuum of Care	Yes	0
RHED	Yes	15
Youthbuild	Yes	15
BEDI	Yes	25
HOPWA (new)	No	20
HOPWA (renewals)	Yes	0

CPD's use of threshold and rating factors can reduce the risk that entities lacking capacity will receive funding. However, the capacity evaluations are based primarily on CPD's prior experience with an entity. CPD does not have procedures for independently verifying assertions made by applicants new to CPD programs. Even if the applicant was a past grant recipient, CPD has limited knowledge of the applicant's capacity without performing on-site monitoring.¹¹ If CPD officials are not familiar with an applicant, they give the applicant the benefit of the doubt in the selection process. Accordingly, despite the consideration given to capacity in the NOFA, CPD cannot be reasonably assured it is only funding applicants with capacity.

¹⁰ A threshold factor is a minimum score or standard required to qualify for funding.

¹¹ As noted in Finding 2, CPD performs a minimal amount of on-site monitoring.

Finding 1

Prior audits illustrate the impact of funding grantees lacking capacity.

Our prior audits have identified nonprofit organizations that do not have the capacity to operate projects within CPD's formula and competitive programs. We have issued 27 audit reports or memorandums from January 2000 through November 2003 showing how nonprofit organizations lack the capacity to operate projects within CPD's formula and competitive programs (see Appendix D). The impact of funding nonprofits without capacity is illustrated by the six audit report examples that follow.

Impact of Funding Nonprofits without Capacity

New York, NY. Safe Space, Inc., a nonprofit organization, did not maintain adequate books and records to account for expenditures charged to the Housing Opportunities for Persons with AIDS and Supportive Housing Programs. Furthermore, Safe Space, Inc. did not maintain adequate documentation to support that grant funds were only expended for eligible activities in an economic and efficient manner and in accordance with grant agreements and applicable laws and regulations. Specifically, Safe Space, Inc. failed to properly maintain accounting records to document the basis for allocating costs charged to the programs. Consequently, Safe Space, Inc. could not provide adequate assurances that \$2,213,000 (\$1,675,799 in Supporting Housing Program funds and \$537,201 in Housing Opportunities for Persons with AIDS Program funds) in costs either paid with grant funds or allocated to activities were actually applicable to the Programs (Audit Memorandum No. 2003-NY-1802).

Atlanta, GA. The National Scholarship Service/Veteran's Opportunity and Resource Center, Inc.'s management did not responsibly manage its Supportive Housing Program grant accounting, expenditures, and compliance with Program requirements. Specifically, the Service/Center did not establish: (1) accounting system procedures and controls needed to comply with federal requirements for grant fund accounting; (2) procedures to ensure only eligible and necessary expenditures were charged to Program grant funds; and (3) procedures to monitor and compare Program expenditures to the approved budget. As a result, grant fund expenditures included \$158,330 of ineligible costs and \$313,811 of unsupported costs. Additionally, \$34,443 of operating expenditures were ineligible for HUD funding because it was not matched by the Service/Center (Audit Report No. 2002-AT-1003).

Waukesha, WI. Waukesha County did not ensure that its Loan Administrator, Waukesha County Economic Development Corporation, a nonprofit organization, followed Federal requirements and the County's Agreements with the Corporation regarding economic development loans. Specifically, the County and the Corporation lacked adequate documentation to support \$463,734 in Block Grant loans were used for eligible expenses. In addition, the County allowed two loan agreements totaling \$306,000 to be executed with provisions that violated Federal requirements and its Agreements with the Corporation. The Corporation's President said he was unaware that supporting documentation must be kept for four years to support the use of Block Grant funds. The County failed to adequately monitor the administrator to ensure that Block Grant Program loans were properly awarded and serviced (Audit Report No. 2004-CH-1002).

Impact of Funding Nonprofits without Capacity

Philadelphia, PA. Resources for Human Development did not: (1) include only eligible costs in its Supportive Housing Program grant draw downs; (2) base draw downs on cash requirements of the Program; (3) classify transactions by type of eligible activity; and (4) file accurate Annual Progress Reports. Specifically, Resources for Human Development exceeded HUD approved budgets for supportive service and administration costs by \$216,345 and incorrectly posted these costs to program operations. Additionally, Resources for Human Development incurred another \$124,480 of ineligible costs for rent, \$1,895 for duplicate payments to vendors, and \$303 of gifts for participants and employees (Audit Report No. 2001-PH-1004).

Houston, TX. The Spanish Village Community Development Corporation (SVCDC), a resident nonprofit group, had not completed HUD-funded renovations on the Spanish Village Apartments more than 4 years after it was supposed to complete those renovations. A 1996 Sales Contract between HUD and SVCDC and a 1997 HOME Loan Agreement between the City of Houston and SVCDC required that SVCDC complete renovations by September 1998. Also, SVCDC expended about \$90,500 in renovations because it did not have the administrative capacity to complete the project in accordance with its agreements with HUD. As a result of SVCDC's inability to complete the renovations, completion of the project is doubtful and Spanish Village residents have continued to live in substandard conditions (Audit Report No. 2003-FW-1004).

Los Angeles, CA. We concluded that Los Angeles Homeless Services Authority (LAHSA) and the El Monte Youth Development Center (El Monte) did not carry out its Supportive Housing grant activities consistent with the application and applicable regulations. LAHSA was a nonprofit entity and the primary administrative agency for distributing Supportive Housing grant funds in Los Angeles County. El Monte, also a nonprofit, was a subgrantee of LAHSA. El Monte admitted ineligible participants and participants whose eligibility was not adequately documented; did not accomplish program goals or maintain evidence of measurable results; did not maintain financial records that support specific grant expenditures; did not follow federal procurement procedures in awarding contracts for services; charged ineligible costs to the grant; and failed to remit interest income earned on federal funds to the U.S. Treasury Department as required. In total, El Monte incurred \$80,639 in eligible costs and \$576,206 in unsupported costs. LAHSA was unaware of the problems at El Monte because they failed to perform timely subgrantee monitoring reviews (Audit Memorandum No. 2001-SF-1803).

CPD's risk is highest with the RHED, Youthbuild, and BEDI programs.

CPD's risk of selecting applicants without sufficient capacity is higher with the Rural Housing and Economic Development (RHED), Youthbuild, and Brownfields Economic Development Initiative (BEDI) Programs. This is because field office involvement in the selection process is minimal. For the Continuum of Care Programs, Headquarters officials from the Office of Special Needs Assessments Programs (SNAPS) recognize that field office personnel are the most familiar with the organizations applying for funding from within their jurisdictions. Accordingly, they delegate responsibility for performing the threshold review of capacity to the field offices. SNAPS officials later review the field offices assessments and have the authority to override field office conclusions. According to the Director of SNAPS, this occurs about 10 percent of the time. For the RHED, Youthbuild and BEDI programs, the selection process is performed entirely at Headquarters. Field office involvement is limited and as a result, the CPD officials most likely to have knowledge of applicants' organizational capacity and past performance are not included in the selection process.

CPD set the capacity threshold scores too low for RHED, Youthbuild and BEDI to effectively eliminate applicants without capacity.

CPD set the capacity thresholds too low for RHED, Youthbuild and BEDI to be effective. For all three programs, CPD used a combined score from two rating factors, one of which was capacity, as a funding threshold. For RHED and Youthbuild, CPD set the threshold score so low applicants were able to pass the threshold requirement even if they received no points for capacity. For BEDI, applicants could score as low as 5 out of a total of 25 points for capacity and still meet the threshold requirement. For BEDI, the significant weight given to capacity as a rating factor offsets the risk from the low threshold score. However, for RHED and Youthbuild, CPD weighted capacity as a rating factor much less significantly. To ensure these organizations have adequate capacity, CPD needs to raise the threshold requirement.

CPD needs to strengthen management controls over grantee and subgrantee selection.

Due to the funding process for the formula programs and limitations in available resources for monitoring, CPD cannot mitigate all risks associated with its programs. However, CPD should strengthen its management controls within existing constraints. Specifically, CPD should provide formula grantees with guidance to use in evaluating the capacity of prospective subgrantees. In addition, CPD should involve field office personnel in the

Finding 1

evaluation of capacity for all of its competitive programs and increase the minimum capacity thresholds for the RHED and Youthbuild Programs.

Recommendations

We recommend CPD:

- 1A. Provide guidance for grantees to use to evaluate the capacity of subgrantees.
- 1B. Involve field office personnel as appropriate in the evaluation of capacity for competitive grant programs.
- 1C. Increase the minimum threshold requirement for capacity for competitive grant programs.

CPD Needs to Improve Management Controls over Monitoring Functions

CPD bases its monitoring goals and grantee risk analyses on unverified assumptions. CPD has never evaluated the aggregate risk associated with its programs or made a decision as to what level of risk is acceptable. Further, CPD has not tested its grantee risk analysis process to ensure it accurately identifies the highest risk grantees. As a result, CPD lacks assurance that it has the resources to perform the appropriate level of monitoring. Additionally, CPD cannot demonstrate that it is focusing its limited resources on the highest risk programs and grantees. CPD needs to evaluate program risk and test and adjust its procedures as necessary to ensure monitoring is effective.

GAO's Internal Control Standards list risk assessment as a minimum standard for internal controls.

GAO's Standards for Internal Control in the federal government state that risk assessment is one of five minimum standards for internal controls. Specifically, it states:

“A precondition to risk assessment is the establishment of clear, consistent agency objectives. Risk assessment is the identification and analysis of relevant risks associated with achieving the objectives, such as those defined in strategic and annual performance plans developed under the Government Performance and Results Act, and forming a basis for determining how risks should be managed.

Management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entity-wide and activity level. Risk identification methods may include qualitative and quantitative ranking activities, management conferences, forecasting and strategic planning, and consideration of findings from audits and other assessments.

Once risks have been identified, they should be analyzed for their possible effect. Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions should be taken. The specific risk analysis methodology used can

vary by agency because of differences in agencies' missions and the difficulty in qualitatively and quantitatively assigning risk levels.”

CPD management is responsible for ensuring the adequacy of management controls.

HUD Handbook 1840.1, Rev-3, dated February 1999 provides HUD managers with policies, procedures, and guidance for carrying out an effective management control process within HUD. Paragraph 3-2 states:

“All levels of management are responsible for ensuring the adequacy of controls. Managers must plan and conduct ongoing evaluations of management controls to:

- Ensure that the controls remain effective and efficient, and function as intended and
- Identify management controls that need to be strengthened or streamlined.”

On-Site Monitoring Goals

CPD needs to document the rationale behind its annual monitoring goals.

CPD does not have a documented basis for how it establishes its annual monitoring goals. Each year CPD sets forth the amount of on-site monitoring it intends to perform in its management plan. A committee headed by the Office of Field Management (OFM) establishes the monitoring goals with approval from the Assistant Secretary for CPD. The committee, which includes program directors, meets informally but does not document what they consider in developing the goals. The Acting Deputy provided a general explanation of how the committee developed the percentages. However, there is no support to show the monitoring goals correctly allocate limited staff and travel resources to the highest risk areas.

CPD does not know whether the level of monitoring they are performing provides adequate protection for its programs. CPD has not evaluated the risk of its programs relative to each other or on an aggregate basis.

CPD cannot demonstrate that its monitoring goals provide adequate protection for its programs.

CPD bases monitoring goals upon available resources rather than risk exposure. According to the Acting Deputy Director of the OFM, CPD established the monitoring goals through discussions among committee members. The committee established the monitoring goal for the formula grantees at a level that theoretically would allow each formula grantee to be monitored every 3 years even though in reality this does not happen. The committee sets the monitoring goal for the homeless grantees at the highest percentage they felt the field offices could reasonably accomplish given available resources. The committee established a separate goal of 7 percent for the non-homeless, competitive grants so that the smaller economic grants would qualify to be monitored as well. The director responsible for the Continuum of Care Programs acknowledged that many of the 7,000 active Continuum of Care grants have been around for 8 years and have never been monitored.

Field National Goals for On-Site Monitoring

Grants	FY 2001¹²	FY 2002	FY 2003
Formula	31% of grantees	35% of grantees	35% of grantees
Competitive, Homeless	8% of all competitive grantees	At least one project in each Continuum funded in fiscal year 2000 and other high risk homeless grantees.	20% of all active grantees. Field offices must review at least one grantee in 35% or more of the Continuum of Care systems receiving funding in fiscal year 2001.
Competitive, Non-homeless	8% of all competitive grantees	7% of grantees	7% of grantees

CPD cannot demonstrate that their monitoring goals are consistent with program risk.

CPD officials have not evaluated the relative risk of their programs. CPD’s monitoring goals for formula grantees are significantly higher than for competitive grantees. CPD’s decision to monitor more formula grantees than competitive grantees is reasonable given the size of the grants. However, CPD does not have a basis to conclude

¹² CPD's 2001 monitoring goals were to monitor 350 formula grantees and 300 competitive grantees. The goals were not stated as a percent. The percentages shown are estimates based on the number of grantees in FY 2003.

that their monitoring goal for formula grantees is appropriate in relation to their goals for the competitive grantees. Further, in determining their monitoring goals, CPD needs to consider other risk factors in addition to the size of the grants.

Resources for On-Site Monitoring

CPD goals require on-site monitoring of only a small percentage of grants.

On-site monitoring serves as an important tool for CPD to identify problems and a motivation to all grantees to exercise sound judgment in carrying out their grants activities. On-site monitoring is also essential to the effectiveness of other management controls. CPD cannot be certain of the accuracy of grantee reports and performance data without on-site monitoring. Despite the essential nature of on-site monitoring, CPD goals require monitoring of only a small percentage of grants. The annual CPD Management Plan contains CPD's goals for on-site monitoring. For fiscal year 2003, the plan called for the field offices to monitor 35 percent of formula grantees, 20 percent of homeless grantees, and 7 percent of competitive, non-homeless grantees. However, as noted below, the monitoring goal only required the field offices to monitor 18 percent of formula grants. Similarly, CPD's monitoring goal for Continuum of Care grantees only required the field offices to monitor 7 percent of grants.

CPD's FY 2003 Monitoring Goals

Grant Programs	Number of Grants	Number of Grantees	Percent of Grantees to be Monitored	Percent of Grants to be Monitored ¹³
Formula Programs	2,195	1,143	35	18
Continuum of Care	7,000	2,600	20	7

Available travel dollars limit on-site monitoring.

CPD does not have the travel dollars to increase on-site monitoring. When CPD officials developed the monitoring goals for fiscal year 2003, they did so assuming a 15 percent increase in travel funds from the previous year. They asked the field offices to prepare their work plans on the same assumption. However, when Congress finally approved HUD's budget, CPD travel funds decreased as shown below.

¹³ The column represents the minimum amount of monitoring required to meet the goals. Field offices are not precluded from monitoring more than one grant per grantee.

CPD Travel Dollars by Fiscal Year¹⁴

	FY 2001	FY 2002	FY 2003
Headquarters	\$351,617	\$407,732	\$358,000
Field Offices	388,646	436,797	400,000
Totals	\$740,263	\$844,529	\$758,000

The Office of Field Management asked the field offices to revise their local work plans based on the revised travel dollars. In addition to canceling planned monitoring, field offices had the option of reducing the number of days or the number of staff assigned to a monitoring visit. The Fort Worth field office met its revised travel budget by canceling three monitoring trips and a relocation monitoring trip. They also reduced, by one, the number of field office staff participating in two other monitoring visits.

Despite the reduced travel funds, the field offices still planned to exceed the national monitoring goals for formula and competitive, non-homeless grants, but they did not plan to meet the national goals for the competitive homeless grants (see table below).

	National Target	Original Monitoring Goals	Adjusted Monitoring Goals	Reduction in Monitoring Goals
Formula	400	417	408	(9)
Competitive, Homeless	520	534	489	(45)
Competitive, Non-homeless	80	124	121	(3)

Reductions in field office staffing levels impact CPD's monitoring capabilities.

Over the last 10 years, CPD has been negatively impacted by staffing challenges that have plagued all of HUD (see Appendix B). HUD reduced CPD's staffing level without any type of workload study to support the reductions. At the same time, CPD continued to experience increases in the size of its programs.

¹⁴ The numbers for fiscal years 2001 and 2002 are actual numbers. The numbers for fiscal year 2003 is CPD's allocation for the year.

Comparison of Fiscal Year 1993 and 2003 Program and Staffing Levels

	<i>1993</i>	<i>2003</i>	<i>Percent Change</i>
Number of Programs ¹⁵	22	22	None
Dollar Value of Programs	\$6.2 billion	\$8.5 billion	↑ 37%
Number of CDBG Grantees	940	1,085	↑ 15%
Number of HOME Grantees	394	625	↑ 59%
Number of Continuum of Care Grantees ¹⁶	1,200	7,000	↑ 583%
CPD Field Office Staff	751	675	↓(11%)
Total CPD Staff	1,016	931	↓ (9%)

Under pressure from Congress, HUD conducted a resource allocation study in 2001 to estimate its personnel needs. The Resource Estimation and Allocation Process (REAP) study recommended a staffing level of 806 Full Time Equivalent (FTE) positions for CPD, considerably less than its current staffing level of 931. CPD disagreed with the study’s methodology and results. Until recently HUD did not hold CPD to the study’s FTE limit. However, as shown below, CPD must now reduce its staff to the level of 821 supported by the REAP study.¹⁷

CPD Staffing Levels

	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>
<i>Headquarters</i>	236	266	256	
<i>Field Offices</i>	556	670	675	
<i>Total</i>	792	936	931	821

CPD officials do not believe they have sufficient staff.

Even before the mandated staffing reductions required by HUD’s corrective action plan, CPD officials did not believe their current staffing level was adequate. CPD program officials consistently stated they did not have sufficient staff to monitor effectively. The Deputy Director for the Office of Block Grants pointed out that CPD has experienced a steady downward trend in CPD staffing since the early 1980’s both in absolute terms and as a percentage

¹⁵ These numbers do not include directed grants, terminated programs with open grants, or initiatives created from existing programs (see Appendix B). Combined these activities significantly impact the workload of CPD at the Headquarters level.

¹⁶ The Office of Special Needs Assistance Programs (SNAPS) administers the Continuum of Care programs. According to the director, it now takes 6-1/2 months to process the grants from the point of application to the point where the Secretary announces the awards. Everyone in the Office of SNAPS participates in the process. The field offices take approximately 3 months to review the applications for capacity.

¹⁷ HUD derived CPD’s adjusted FTE limit by prorating HUD’s overall FTE limit of 9,278.

of the Department's overall budget. At the same time, CPD's program administration responsibilities have increased in terms of the number of programs administered, the dollar amount of CPD's appropriation and the percent of CPD's appropriation to HUD's total budget. The Director of HIV/AIDS said CPD is officially over ceiling. His portfolio continues to grow while his staff decreases. Some field offices are overstaffed, but others are critically understaffed. When asked whether she thought her office had adequate staff to monitor effectively, a Headquarters' director with the Office of SNAPS replied:

"The field offices, no. Headquarters, no. On top of everything else they have to do, [Headquarters' staff] now have to be involved in an interagency NOFA.¹⁸ Each person involved with the Continuum of Care selection process must review anywhere from 24 to 32 Continuums and anywhere from 150 to 250 applications."

Skills and program knowledge of existing staff also impact monitoring capabilities.

Staff redeployments, accompanied by a lack of emphasis on training, have weakened CPD staff expertise. HUD redeployed a number of staff to CPD due to organizational changes related to HUD's 2020 Management Reform Plan¹⁹ and the elimination of the Community Builder initiative.²⁰ During the redeployment, HUD provided staff with an overall orientation to HUD and its programs; however, they did not provide program specific training. While some former Community Builders worked for CPD previously, most staff redeployed to CPD were unfamiliar with CPD programs or operations. CPD provided an orientation course for new employees in January 2001 but did not provide any additional courses for staff hired after that date. Over one-fifth of CPD's staff has been with CPD for less than 3 years.

¹⁸ The U.S. Interagency Council on the Homeless is coordinating a \$35 million joint initiative with HUD, the Department of Veterans Affairs, and the Department of Health and Human Services in support of the Administration's goal to end chronic homelessness. HUD's goal is to end chronic homelessness in 10 years.

¹⁹ See Appendix B.

²⁰ Former Secretary Cuomo established the Community Builder positions as part of his reform efforts under HUD's 2020 Management Reform Plan. The Community Builders were responsible for customer relations and outreach to communities. HUD eliminated the positions at the end of fiscal year 2000.

**Employees Hired or Redeployed to CPD
in the Last 3 Years**

	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>Totals</i>
<i>Headquarters</i>	24	50	9	83
<i>Field Offices</i>	15	94 ²¹	12	121
<i>Totals</i>	39	144	21	204

CPD only provided a minimal amount of training for existing staff over the last 3 fiscal years (see Appendix C). CPD provided the most training for CDBG. Twenty-five percent of CPD staff attended CDBG training during the last 3 fiscal years. However, only 12 percent of CPD staff received training on the HOME Program and only 16 percent on the Continuum of Care Programs during the same time period. Further, CPD has not provided any training for the ESG, RHED, Youthbuild, or BEDI Programs in the last 3 years. Fiscal year 2003 training was particularly limited due to the delay in Congress passing the budget and the tightness of the budget overall. CPD only provided two program specific courses. CPD provided some additional training in specialized areas to complement the program specific training. However, CPD only offered this training to a small number of staff.

Some field offices lack the financial expertise to monitor effectively.

A shortage of financial analysts limits the effectiveness of field office monitoring. Field offices are responsible for assessing the financial performance of grantees on an ongoing basis. They review budget submissions for competitive grants, financial report submissions, drawdown requests and Single Audit Act reports. Ideally, during on-site monitoring, field offices review grantees' general ledger accounts and supporting documentation to ensure costs are allowable. They also compare grantees' general ledger accounts to data in their most recently submitted financial reports to check for accuracy as well as performing other checks of financial data. Despite the level of financial expertise necessary to carry out these activities, 17 field offices do not have a financial analyst on staff. Financial expertise is required to ensure CPD's monitoring activities adequately address the financial vulnerabilities of CPD programs and related capacity concerns.

²¹ Former Community Builders accounted for 51 of these positions.

<i>Field Offices Without Financial Analysts</i>		
<i>Albuquerque</i>	<i>Detroit</i>	<i>Louisville</i>
<i>Anchorage</i>	<i>District of Columbia</i>	<i>Minneapolis-St. Paul</i>
<i>Baltimore</i>	<i>Greensboro</i>	<i>Omaha</i>
<i>Birmingham</i>	<i>Honolulu</i>	<i>Pittsburgh</i>
<i>Columbia</i>	<i>Indianapolis</i>	<i>San Antonio</i>
<i>Columbus</i>	<i>Little Rock</i>	

CPD lacks a supportable basis for requesting additional resources.

Since CPD has not evaluated the risk exposure of its programs or made a determination as to what is acceptable risk, they cannot put forth a definitive position regarding needed resources. If HUD or Congress questions CPD's resource needs, CPD lacks a supportable basis to defend them. This places CPD at a disadvantage when competing for limited resources as is apparent from the disagreement over appropriate CPD staffing levels and the REAP study methodology.

The original REAP study concluded CPD needed less staff than its current number of FTEs. CPD officials contend that the study was unfair to CPD in that it did not take into consideration overtime worked or work they were unable to perform due to a lack of staff. Budget officials acknowledged the methodology improved over time. Accordingly, HUD has agreed to undertake a new REAP study for CPD.

Selection of Grantees for On-Site Monitoring

CPD has developed a process for selecting grantees to monitor.

In fiscal year 2003, CPD developed a process for field offices to use in selecting grantees for on-site-monitoring. The process calls for the field offices to score each grantee as low, moderate, or high risk based upon a set of risk ranking factors. Field offices must monitor all high-risk grantees on-site unless they can apply valid exceptions or reasons for excluding them. They can select additional grantees for monitoring only as staff and travel resources permit. While CPD's risk assessment provides a basis for allocating limited resources, CPD has not tested the process. Accordingly, its actual effectiveness at identifying high-risk grantees is yet to be determined.

Risk analysis ranks grantees in order of their risk score.

Field offices select grantees for monitoring based on their average score from all CPD programs in which they participate. Using the point values, field offices can rate grantees as low risk (30 or below), moderate risk (31-64), or high risk (65 or higher). All high-risk grantees must be monitored. Also, any grantee with a single program scoring 75 or higher must also be monitored. The field offices are allowed to pass over a high-risk grantee for monitoring, but only under specific exceptions.

CPD needs to test the validity of its risk analysis process.

In order to ensure the validity of its risk analysis process, CPD needs to test its effectiveness at identifying high-risk grantees. CPD should compare the significance of monitoring findings and concerns to grantees' risk assessment scores to determine whether a correlation exists. Special note should be made of any instances where significant monitoring findings were identified during monitoring of grantees rated as low risk or vice versa. CPD will need to monitor at least some grantees rated as low risk for comparison purposes. Without such an analysis, CPD cannot state with any certainty that its process effectively targets its limited resources to the highest risk grantees.

Recommendations

We recommend CPD:

- 2A. Document the basis for establishing annual monitoring goals.
- 2B. Evaluate the risks associated with CPD's programs and make a determination as to what level of risk is acceptable.
- 2C. Ascertain the appropriate level of on-site monitoring based on the determination of acceptable risk.
- 2D. Increase program training for field office staff responsible for monitoring.
- 2E. Provide field offices with appropriate financial analyst capability.
- 2F. Test the validity of its risk assessment process.

Issue Needing Further Study or Consideration

Congress has not appropriated technical assistance funds for CDBG, CPD's largest program, since fiscal year 1999. CPD can use technical assistance funds to increase grantee understanding of capacity requirements through training and the provision of web resources, guidebooks and other resources. CPD does not know why Congress continues to decline providing funding. The lack of technical assistance funding prevents CDBG from developing the types of resources other CPD Programs have for increasing capacity. CPD needs to ascertain the reasons Congress denied funding to CDBG and address Congressional concerns. CDBG should also consider providing a more specific description of grantee needs and the use of technical assistance funds to meet those needs.

Technical assistance funding is designed to increase CDBG grantee capacity.

The CDBG program uses available technical assistance funds to increase grantee capacity. Other CPD Programs have used technical assistance funds to provide training, online resources, guidebooks, and other resources to increase grantees' knowledge of program requirements. Yet, despite repeated requests by CPD, Congress has not appropriated any technical assistance funds for CDBG since fiscal year 1999. The CDBG Program is CPD's largest grant program accounting for nearly 60 percent of all funding for CPD Programs. Accordingly, the performance of its grantees is critical to CPD's overall mission.

CPD uses technical assistance to increase the capacity of grantees.

CPD uses technical assistance monies to increase the capacity of program participants. Technical assistance funds may be used for training courses, conferences, one-on-one assistance, and the development of web resources and guidebooks. The HOME Program continues to benefit from consistent funding of a significant amount of technical assistance monies. HOME used its funds to develop ten model guides, six web-based training modules, and nine training courses. HOME provided the training courses, free-of-charge, in over 200 communities nationwide over the last 2 years. The HOPWA Program used a portion of its technical assistance funds to conduct four national conferences on HIV/AIDS housing and provide individual assistance to grantees. The homeless programs used technical assistance funds to develop a wide range of training materials as well as conducting three workshops and five regional housing conferences. The training materials and courses financed by technical assistance funds have the potential to significantly increase

the capacity of participants responsible for administering CPD's programs.

Other CPD Programs' funding needs have been met.

As can be seen from the table below, technical assistance funding has not been consistent across the programs. Congress appropriated technical assistance funding for the HOME, HOPWA, Homeless, and Youthbuild Programs in each of the last 3 fiscal years. However, they did not appropriate any technical assistance funds for CDBG, RHED, and BEDI during the same time period. The Director of the Office of Rural Housing and Economic Development said her office was not impacted by the lack of funding as they are still in the process of expending fiscal year 1999 and 2000 funds for a clearinghouse for rural housing. The BEDI Program Coordinator said to his knowledge BEDI has never received technical assistance funds, but they have received allocations for grantees and nonprofits to attend the National Brownsfield Conference. He expects they will continue to receive this funding. However, officials with the Office of Block Grants stated CPD's largest grant program needed technical assistance funding.

Technical Assistance Funding

Program	Fiscal Year 2003	Fiscal Year 2002	Fiscal Year 2001
CDBG	\$0	\$0	\$0
HOME	\$17,883,000	\$12,000,000	\$21,952,000
HOPWA	\$2,000,000	\$2,000,000	\$2,574,000
ESG and Continuum of Care	\$6,600,000	\$6,600,000	\$7,700,000
RHED	\$0	\$0	\$0
Youthbuild	\$2,980,000	\$3,250,000	\$2,993,000
BEDI	\$0	\$0	\$0

CPD continues to request technical assistance funding for CDBG.

CPD has requested technical assistance funds for CDBG every year since 1999 with the exception of 2002.

Requests for Technical Assistance Funding for CDBG

Fiscal Year	Funding Requests
2000	\$7,500,000
2001	\$15,000,000
2002	\$0
2003	\$3,000,000
2004	\$3,000,000

In HUD’s fiscal years 2003 and 2004 budget justifications, CPD provided Congress with detailed justifications for its requests for technical assistance for CDBG. For fiscal year 2003, CPD noted that technical assistance funds allow CPD to provide assistance both directly and through contractors to assist grantees. CPD proposed focusing funding on improving: (1) the timeliness of grantee expenditures; (2) the economic development potential of grantees; (3) the leveraging of CDBG funds; and (4) other special areas including homeownership, faith-based initiatives, energy conservation, lead safe housing, Section 108, and local performance measurement. CPD also proposed funding for reforming the Consolidated Plan. CPD concluded its request by noting the following:

“The CDBG program has not received any funding for Technical Assistance in the past 3 years and there is increasing pressure for this funding from CDBG grantees because of considerable staff turnover at the local level translating into a pent up need for CDBG training. This request will provide for community development and job creation training for localities and capacity building (including operating and project costs) of neighborhood based and community development organizations and nonprofits that wish to participate in local community development.”

CPD officials said they do not know why Congress has chosen not to approve technical assistance funding for CDBG. CPD should consider meeting with Congressional staff to ascertain why Congress has denied past funding requests and determine whether Congressional concerns

can be addressed. CDBG should also consider enhancing the language in future budget justifications to demonstrate the need to increase grantee capacity and outlining the specific results to be achieved.

CPD Programs and Initiatives

Program/Initiative Titles		FY 2003 Appropriation
	Community Development Block Grants:	
1	Entitlement	\$3,037,677,000
2	Non-Entitlement	1,301,862,000
3	Insular Areas	7,000,000
4	Disaster Assistance	0
5	Section 108 Loan Guarantees	0
	Community Development Block Grant Set Asides:	
6	Self-Help Homeownership Opportunities Program	25,086,000
7	Youthbuild	59,610,000
	Empowerment Zones/Enterprise Communities/Renewal Communities:²²	29,805,000
8	Empowerment Zones	
9	Enterprise Communities	
10	Renewal Communities	
11	Brownfields Economic Development Initiative	24,838,000
12	Rural Housing and Economic Development	24,838,000
	HOME Investment Partnership Grants:	
13	Local Governments	1,109,926,000
14	States	739,951,000
15	Insular Areas	3,895,000
	Homeless Assistance Grants:	1,207,103,000
16	Supportive Housing	
17	Shelter Plus Care	
18	Single Room Occupancy	
19	Emergency Shelter Grant	
20	HOPWA formula	261,091,800
21	HOPWA competitive	29,010,200
22	Church Arson	0
	TOTAL	\$7,861,693,000

²² The fiscal year 2003 appropriation was for Round II Empowerment Zones and Enterprise Communities only.

Congressional Earmarks and Directed Grants

Earmarks/Directed Grants		FY 2003 Appropriation
1	Economic Development Initiatives	\$259,304,000
2	Neighborhood Initiatives	41,846,000
3	Capacity Building-National Community Development Initiative	28,066,000
4	Wellstone Center for Community Building	8,942,000
5	National Housing Development Corporation	4,968,000
6	National Council of LaRaza/HOPE Fund	4,968,000
7	Habitat for Humanity	4,222,000
8	Youthbuild USA	2,000,000
TOTAL		\$354,316,000

Terminated Programs²³

(CPD is in the process of closing these programs out.)

1	Urban Development Action Grants
2	HOPE 3
3	Homeownership Zones
4	Economic Development Initiative (competitive)

Initiatives within Existing Programs²⁴

1	HOME: American Dream Downpayment Initiative
2	HOME: Lead Safe Homes Demonstration
3	Homeless Assistance Grants: Demonstration with the Interagency Council on the Homeless

²³ CPD is in the process of closing these programs. However, CPD still has oversight responsibilities for open grants from prior years.

²⁴ These initiatives represent separately funded activities within existing programs.

History of HUD's Human Resource Management Challenges and their Impact on CPD

Staffing has been a department-wide concern since Secretary Cisneros started in December 1994 to reduce HUD staff from 13,000 to a target of 7,500. In 1997, Secretary Cuomo incorporated the 7,500 target into his 2020 Management Reform Plan; but both the GAO and the OIG criticized the 7,500 number because it was adopted without performing a detailed analysis of HUD's mission and projected workload. HUD stopped downsizing in May 1998 and decided to maintain staffing at around 9,000.

HUD's 2020 Management Reform Plan called for the staff reductions to occur in conjunction with other organizational and programmatic changes including reducing the number of programs, reorganizing the field offices, consolidating processes and functions within and across program areas into specialized centers, and modernizing and integrating the financial and management information systems. HUD consolidated and streamlined some of its operations but was unable to gain Congressional approval for reducing the number of programs. Further, HUD never implemented its proposal to convert CPD's competitive homeless grants to formula grants.

Just prior to the implementation of HUD's 2020, CPD also made a number of changes designed, in part, to reduce staff workload. CPD:

- 1) Consolidated the reporting for all formula grants into a single report;
- 2) Developed the Integrated Disbursement and Information System (IDIS) for formula grantee drawdowns and reporting; and
- 3) Developed the Grants Management Process (GMP) system²⁵ to track monitoring activities.

CPD successfully implemented the consolidated report or CAPER, but not the IDIS and GMP systems. In April 1999, GAO issued a report highly critical of both the IDIS and GMP systems.²⁶ In May 2000, the OIG followed with a report critical of IDIS.²⁷ Problems with both systems remain.

Congress shared GAO and OIG concerns that HUD lacked a basis for supporting its staffing level. In June 1997, Congress asked the National Academy of Public Administration (NAPA) to examine HUD's practices for estimating human resource needs. NAPA issued a report in 1999. The report recommended HUD adopt a management approach that based staff estimates and allocations on the level of work and the location where the work is needed. HUD agreed to work with NAPA to implement the report recommendation. In January 2002, HUD completed its Resource Estimation and Allocation Process (REAP) study for estimating human resource needs.

²⁵ Originally, CPD designed the GMP system to be limited to formula grantees. Later, they added competitive grantees to the system.

²⁶ COMMUNITY DEVELOPMENT - Weak Management Controls Compromise Integrity of Four HUD Grant Programs, General Accounting Office, GAO/RCED-99-98, April 1999.

²⁷ HUD OIG Audit Report, Integrated Disbursement and Information System (IDIS), 00-DP-166-003, May 11, 2000.

The REAP study concluded that HUD needed to increase its FTEs to 10,080, increasing CPD from 757 to 806 people.

HUD never requested staffing at the REAP supported level of 10,080. For fiscal year 2003, HUD requested 9,100 FTEs. Congress provided an FTE level of 9,100. However, due to deficiencies in the Office of Human Resource's operations, HUD actually exceeded its FTE level in the early part of fiscal year 2003. Moreover, HUD did not use the REAP analyses when making those hiring decisions. Congress agreed to revise HUD's fiscal year 2003 ceiling to 9,278 FTEs and allow HUD to reprogram \$20 million to cover the additional personnel costs. HUD requested 9,330 FTEs for fiscal year 2004.

In June 2003, HUD submitted a corrective action plan to Congress to address its personnel deficiencies. In its plan, HUD agreed to align program staffing levels with REAP ceiling levels by September 30, 2004, by prorating the 9,278 FTEs. Per the plan, CPD must reduce its FTE level from 931 to 821.

CPD Training

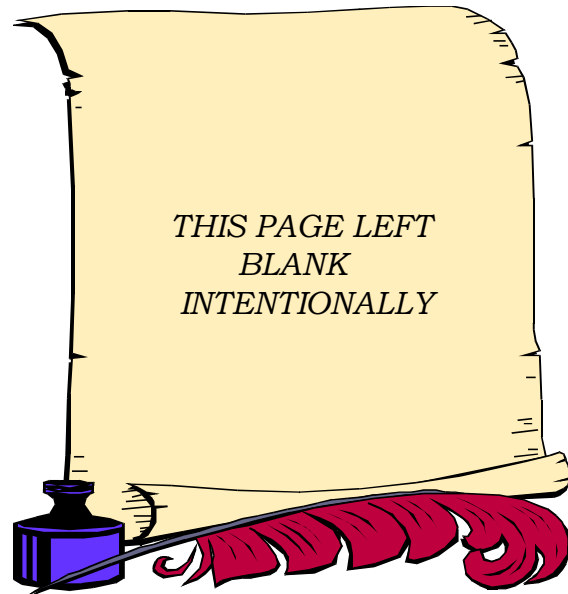
CPD Program Technical Training (fiscal years 2001-2003)

Programs	Course Title	Dates	Number of Participants
CDBG	CDBG	November 28-30, 2000	50
	CDBG	June 19-22, 2001	60
	State CDBG	August 13-16, 2002	70
	State CDBG	December 10-13, 2002	55
HOME	HOME	October 2000	50
	HOME	August 6-9, 2001	65
HOPWA	Spotlight on Special Needs with HOPWA	February 12-15, 2001	50
	Spotlight on Special Needs with HOPWA	June 11-14, 2001	60
	HOPWA	September 24-26, 2002	60
ESG	None		-
Continuum of Care	Spotlight on Special Needs – Homelessness	August 14-15, 2002	100
	Homeless Assistance Training	October 16-17, 2002	50 ²⁸
RHED	None		-
Youthbuild	None		-
BEDI	None		-
Section 108	Section 108 Nuts & Bolts	October 3-6, 2000	37

CPD Specialized Areas Training (fiscal years 2001-2003)

Specialized Areas	Course Title	Dates	Number of Participants
Economic	Economic Development	February 26-March 02, 2001	60
	Economic Development	May 21-25, 2001	60
Environmental	Environmental Training	September 11-14, 2001	24
	Environmental Training	September 18-20, 2002	35
	Basic Environmental	January 27-31, 2003	10
	Environmental	June 26, 2003	200*
Financial	Financial Management-Basic	August 19-23, 2002	63
	Financial Management-Indirect Cost	September 18-20, 2002	60
Management	CPD Managers Training	June 4-6, 2002	135
Relocation	Relocation	June 18-20, 2002	60

²⁸ CPD provided the Homeless Assistance Training via satellite. CPD estimated the number of participants.



OIG Reports that Address Capacity Issues with Nonprofits

Audit Report/Memorandum Title, Number and Date	Deficiencies Found Related To			
	Records	Accounting	Procedures/ Controls	Program Knowledge
Waukesha County Community Development Block Grant and Home Investment Partnership Programs, Waukesha, Wisconsin (2004-CH-1002, November 26, 2003)	X		X	
Use of HUD Grant Funds, East Meyer Community Association, Kansas City, Missouri (2004-KC-1001, November 24, 2003)	X		X	
1736 Family Crisis Center (FCC), Supportive Housing Program, Los Angeles, California (2003-LA-1802, September 12, 2003)		X	X	
Supportive Housing Program Grants, Colorado Coalition for the Homeless, Denver, Colorado (2003-DE-1006, August 26, 2003)		X	X	
Indiana State Department of Health, Housing Opportunities for Persons With Aids Program, Indianapolis, Indiana (2003-CH-1020, July 29, 2003)	X		X	
Safe Space, Inc., HOPWA Grant No. NYH00-0020 and SHP Grant No. NY36B97-0025, New York, New York (2003-NY-1802, July 24, 2003)	X			
Housing Continuum, Inc. Homebuyers Assistance Program Geneva, Illinois (2003-CH-1017, June 13, 2003)			X	
Spanish Village Community Development Corporation, Upfront Grant and Home Loan, Houston, Texas (2003-FW-1004, April 28, 2003)			X	
Oakwood Neighborhood Association Community Development Block Grant Program, Kalamazoo, Michigan (2003-CH-1015, April 24, 2003)	X	X		
HOME Program and CDBG Funds Provided to the Community Resource Center in Bremerton, Washington (2003-SE-1801, January 31, 2003)		X		
New Covenant Housing Corporation, Inc., CDBG & HOME Programs, Milwaukee, Wisconsin (2003-CH-1002, October 29, 2002)		X		
Congressionally Requested Audit of the Outreach and Training Assistance Grant Awarded to the Southern Arizona People's Law Center, Tucson, Arizona, Grant No. FFOT00003AZ (2002-SF-1007, September 30, 2002) ²⁹	X	X	X	
Audit of the Supportive Housing Program Grant to the National Scholarship Service and Veteran's Opportunity and Resource Center Atlanta, Georgia (2002-AT-1003, July 25, 2002)	X	X	X	
City of Philadelphia, Shelter Plus Care Grant, PA26C960002, Philadelphia, Pennsylvania (2001-PH-1802, August 24, 2001)	X	X	X	
Supportive Housing Program Grants Administered by the City of Seattle as Part of the Seattle-King County Continuum of Care Strategy, (2001-SE-251-1001, August 15, 2001)	X			X
Audit of the Philadelphia Department of Commerce's Loan Assistance to the Urban Education Development Research and Retreat Center (UEDRARC) Rehabilitation Project (2001-PH-1006, August 1, 2001)	X	X	X	
Los Angeles Homeless Services Authority, El Monte Youth Development Center, SHP Grant CA16B97-0021, Los Angeles, California (2001-SF-1803, May 23, 2001)	X	X	X	X
County of Orange, Mercy House Coalition, SHP Grant CA16B802-006, Santa Ana, California (2001-SF-1804, May 9, 2001)	X	X	X	X
Resources for Human Development, Supportive Housing Grants, PA26B8941402 (Renewal) and PA26B970105 (Renewal), Philadelphia, Pennsylvania (2001-PH-1004, April 20, 2001)		X	X	X
Aids Foundation Houston, Inc., Supportive Housing Program Grant TX21B97-1304, Houston, Texas (2001-FW-1803, March 9, 2001)	X	X	X	
Greater Dallas Council on Alcohol and Drug Abuse, Supportive Housing Grant TX21B970908, Dallas, Texas (2001-FW-1802, February 13, 2001)		X		X
Adopt-A-Family of the Palm Beaches, Inc., Supportive Housing Grant, West Palm Beach, Florida (01-AT-251-1002, November 3, 2000)	X		X	
Urban Education Development Research and Retreat Center (UEDRARC), Philadelphia, Pennsylvania (01-PH-241-1001, November 2, 2000)		X	X	
Houston Regional HIV/AIDS Resource Group, Inc., Supportive Housing Grant TX21B96-0617, Houston, Texas (00-FW-251-1806, September 27, 2000)	X	X	X	
Houston Regional HIV/AIDS Resource Group, Inc., Houston, Texas, HOPWA 94 and SHP-95 Grants, Improper Use of Grant Funds (00-FW-251-1805, September 5, 2000)	X	X		
Colorado Housing Opportunity for Persons With Aids Program (00-DE-259-1001, February 25, 2000)	X		X	X
Dallas Jewish Coalition for the Homeless, Supportive Housing Grant TX21B960501, Dallas, Texas (00-251-FW-1801, January 18, 2000)	X	X		
Total (27)	18	19	20	6

²⁹ The nonprofit charged costs to the Outreach and Training Assistance Grant that had already been reimbursed with CDBG and ESG funds.



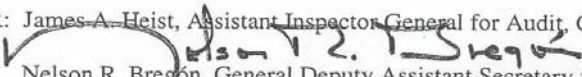
Auditee Comments



U.S. Department of Housing and Urban Development
Washington, D.C. 20410-7000

OFFICE OF ASSISTANT SECRETARY
FOR COMMUNITY PLANNING AND DEVELOPMENT

FEB 11 2004

MEMORANDUM FOR: James A. Heist, Assistant Inspector General for Audit, GA
 FROM: 
 Nelson R. Bregon, General Deputy Assistant Secretary for
 Community Planning and Development, D
 SUBJECT: Comments on Draft Audit of Community Planning and
 Development (CPD) Grantees and Subgrantees

On December 17, 2004, CPD staff met with you and Laura Nixon of your Ft. Worth audit office to discuss our concerns regarding the Office of Inspector General's (OIG) draft audit of the capacity of CPD grantees and subgrantees. We provided extensive comments during that meeting regarding unsupported and/or inaccurate statements included in the report. On January 12, 2004, we received a second draft of the report by e-mail from Ms. Nixon.

Our review of the report indicates that it is fatally flawed. Few, if any, of our issues were addressed. We therefore ask that the audit report be withdrawn. Upon reading this report, neither the Congressional requestor nor any reader would understand CPD's process for assessing the capacity of nonprofits it funds. The report is rife with erroneous information and fails to meet general auditing standards.

Notwithstanding CPD's position, HUD Handbook 2000.06, Rev 3, "Audits Management System," Section 3-1.B.2, requires that the OIG give full consideration to our comments. Even if the report were issued, it would require substantial changes before releasing it as final. The report's faulty premises and errors are described below.

Overview

It is our belief that the draft report does not respond to the Congressional request that, as was explained to CPD, sought an OIG review of HUD's ability to assess the capacity of nonprofits it funded. OIG decided to: (1) limit its review to CPD; and (2) expand the scope of the Congressional request "to include all grantees and subgrantees." This is misleading. First, the report does not include CPD's universe of funded entities. Second, the report overlooks the significant differences between CPD's formula and competitive programs vis-à-vis the role of nonprofits. Depending on the program, nonprofits can either be direct recipients of CPD funds or receive subgrants from CPD grantees. The differences with respect to the processes, procedures and controls for assessing nonprofit capacity are profound, depending on this funding relationship.

Comment 1

Comment 2

Comment 3

Comment 4 Furthermore, the report applies an OIG-developed definition of “capacity,” which in itself would invalidate the report. The OIG needs to indicate which programs (that fund nonprofits) have a definition of capacity, include the definition, and conduct its audit work accordingly. The report also operates on the flawed premise that CPD may only fund grantees with capacity. It gives scant heed to the statutory basis for funding entitlement grantees (and their due process rights regarding the withholding of funding based on “capacity”) and simultaneously fails to acknowledge Congress’s inclusion of capacity building in certain CPD programs, which is an explicit acknowledgement that a lack of capacity does not stand as a bar to funding. These deficiencies result in a report that misinforms the reader.

Comment 5

Comment 6 The lack of evidence to support statements made and other inaccuracies in the report are also very troubling. The auditor states on page 5 of the report that field tests of controls were not performed. This is particularly disturbing, as the purported purpose of the audit was to determine what controls HUD had in place to determine the capacity of grantees and subgrantees, which are external to HUD, and if such controls work. We therefore question the statement included on page 6 of the report that the audit was performed in accordance with the General Accounting Office’s (GAO) Government Auditing Standards (GAS). This is particularly problematic as it relates to Chapter 7 of GAS entitled “Field Work Standards for Performance Audits” and Chapter 8 entitled “Reporting Standards for Performance Audits”.

Specific Report Comments

Finding 1: CPD’s Management Controls Do Not Provide Adequate Protection Against Funding Grantees Lacking Capacity - We disagree with this statement. Our page-by-page review of this finding follows.

Page 8-

- **Funding for formula grantees does not consider capacity.**

Comment 7 The highlighting of this statement in the expanded left margin of the report gives the impression that CPD has been remiss in not considering capacity before allocating funds to formula grantees. Statutes authorizing these programs provide for the distribution of funds based on a formula. Capacity is not included as a formula factor for CPD’s entitlement programs.

However, if a formula grantee is found to be lacking in capacity CPD moves to take appropriate action. Technical assistance (TA) to help the grantees correct capacity issues is also provided by CPD staff and/or CPD-funded TA contractors.

- **CPD does not terminate funding for grantees shown to lack capacity.**

Comment 8

The highlighting of this statement in the expanded left margin of the report conveys the OIG’s opinion that CPD should not attempt to correct capacity problems when detected, but should move to terminate funding whenever this occurs. The termination of funding is the most drastic action that can be taken and ultimately hurts the intended beneficiaries of CPD programs. This is a “walk away” approach where CPD believes a “work with” approach (win-win) is generally more effective in resolving capacity deficiencies.

Comment 9

CPD seeks to take effective corrective actions in dealing with capacity issues. Stringent methods for egregious cases include the suspension of funds until the problems are mitigated, and/or the reduction of future funding to cover any ineligible costs.

Comment 10

Notwithstanding CPD’s desire to build capacity, the statement on page 9 that no audit work was performed to determine the effectiveness of CPD’s enforcement work, undermines any statement, either pro or con, regarding our efforts in this area.

Page 9-

- **CPD appears to operate formula programs according to Congressional intent.**

Comment 11

If this statement is going to be made, the auditor should be able to say, based on an appropriate level of testing, that we do or do not operate the formula programs according to Congressional intent, not that it appears we do. Absent such evidence, the statement is strictly an opinion, lacking a factual basis. For the record, we do operate the formula programs in accordance with Congressional intent.

Comment 12

The report states that CPD’s management controls allow for the possibility of CPD unknowingly funding grantees that lack capacity. It further states that the lack of controls also allows for the possibility of CPD continuing to fund grantees whose poor performance has demonstrated a lack of capacity. As stated previously, existing statutes for the formula programs do not include a capacity determination in calculating grantee funding amounts and distribution of these funds. CPD’s management controls do provide for capacity determinations, but must operate within the statutorily imposed due process rights of entitlements.

Comment 13

Second, the auditor has not proven through appropriate testing that we have weaknesses in the formula grant programs that lead to grantees being funded that lack capacity. CPD has approximately 1,160 formula grantees. Three examples are cited on page 8 of formula grantees that lacked adequate capacity. One of these examples is not even a formula grant program (Section 108 and EDI). It is statistically invalid to draw a conclusion using just two grantees.

- **Formula grantees may not know how to evaluate the capacity of subgrantees.**

Comment 14

The report incorrectly uses an OIG definition of capacity. That, combined with the failure to appropriately test, undermines the supposition that grantees may not know how to evaluate the capacity of subgrantees. If the auditor did not test and did not speak to and/or visit any formula grantees to understand their process, the conclusion that formula grantees may lack such capacity is questionable at best.

Pages 10-11

- **CPD does not have any current guidelines for evaluating the capacity of grantees.**

Comment 15

That is not a true statement. Our largest formula grant program, the Community Development Block Grant (CDBG) program, has three guidebooks involving the evaluation of subgrantee capacity. “A Guideline for Grantees on Subrecipient Oversight,” “A Handbook for CDBG Subrecipients on Administrative Systems,” and a “Training Guide for CDBG Grantee Training of Subrecipients in Administrative Systems” were developed in 1993 to assist grantees in evaluating the capacity of subrecipients. Although they are currently being updated, all are available through HUD’s Community Connections and were provided to the auditor, despite the fact that it is stated in the report that they are out of print.

The availability and value of this CDBG guidance were reported in an OIG audit of Kansas City, Missouri, audit report number 2001-KC-1004 dated July 9, 2001 (see pages 5, 10, 16, and 19 of this audit). The auditor specifically states on page 19 of the cited report, the following:

“The guidebook (A Guidebook for Grantees on Subrecipient Oversight) provides valuable information on how to implement a comprehensive system of subrecipient oversight, including detailed examples of risk assessment checklists and suggestions for documents oversight efforts.”

Comment 16

The Office of Affordable Housing Programs (OAHP) also has several evaluative tools to report on performance in the HOME program, our second largest formula grant program. Among the reports and instructions made available to the field are the Monthly Status Reports on HOME Deadline Requirements. To the extent that capacity involves timely expenditure of funds, this report allows monitoring compliance with the 2-year commitment and CHDO reservation requirement of the HOME statute and the 5-year expenditure requirement of the HOME regulations. Through these reports and coordination with our field offices, OAHP has deobligated more than \$20 million from nonperformers, which has been reallocated through the formula or through a competitive process.

Comment 17

Another report is the HOME Program Performance SNAPSHOT, which is a quarterly cumulative report on eight performance indicators that track participating jurisdictions

(PJs) program progress and production. This report has revealed capacity and reporting problems that both Headquarters and the field have pursued with appropriate PJs, resulting in opportunities to provide technical assistance and training as well as to significant improvement in the quality of performance reporting. The Office of Management and Budget cited the HOME SNAPSHOT as a significant performance tool in the HOME program Performance Assessment Rating Tool (PART) score.

Comment 18 • **CPD lacks sufficient knowledge to evaluate the capacity of some applicants for competitive grants.**

The report provides no examples of competitive grantees that were actually found to lack capacity. It is stated that CPD's capacity evaluations are based primarily on prior experience with an entity, and that we do not have any procedures for independently verifying the veracity of assertions made by applicants new to CPD programs.

Comment 19 As written in the report, CPD considers an applicant's capacity to perform before awards are made. The evaluation of capacity is based on information provided by the applicant in its proposal and on any history of performance on CPD grants, if such exists. We do not attempt to independently verify the accuracy of information provided prior to award because:

- 1- We are prohibited by the HUD Reform Act from making contact with the applicant during the competitive process, except for issues dealing with technical corrections, i.e., failure to sign the application, and
- 2- Resources, both human and otherwise, are not available, nor should they be, to perform such an arduous task that is hardly cost effective. CPD seeks to maximize use of its resources while simultaneously reaching out to cultivate effective providers to implement our programs. We follow the Department's policy of weighing risks against benefits.

Comment 20 Finding 2 – CPD Can Improve Monitoring Functions – Such a statement is a universal given, but CPD has made great strides since 1999 in improving its monitoring functions. These improvements have resulted in monitoring being removed as a HUD material weakness and reportable condition. In addition, GAO in its report GAO-01-248 dated January 2001 entitled “Major Management Challenges and Program Risks” stated that:

“Specifically, because of the actions 1/taken by HUD in response to our recommendations to improve its management controls over its Community Planning and Development program, we no longer believe this HUD program area to be at high risk.”

1/ - The actions referred to by GAO involved improvements in the monitoring of our grant recipients.

We take particular exception to the following issues under this finding.

Page 17

- **CPD does not know whether its monitoring goals provide adequate protection for its programs.**

Comment 21 There is no factual basis for this statement. CPD uses the Departmental risk analysis process to develop its monitoring goals, and thus is reasonably assured that the goals provide sufficient protection for its resources. As stated in the “Purpose” section of CPD’s notice, Notice CPD-02-11, issued December 31, 2002, the process provides “...a consistent methodology for conducting risk analyses that can be used to establish priorities for monitoring and to ensure that CPD’s formula and competitive grantees with the highest risk are identified for monitoring within the resources made available.” (Note: This Notice was reissued on February 2, 2004, as CPD-04-01.)

- **CPD bases monitoring goals upon available resources rather than risk exposure.**

Comment 22 This is not true. Our monitoring goals are developed through the risk analysis process. Available resources are certainly a consideration, particularly for on-site monitoring, but only after high risk grantees are identified. In Fiscal Year (FY) 2003, even though we experienced a reduction in travel funds, we were able to perform on-site monitoring visits at each identified high-risk grantee nationwide. We did this by giving the field offices a larger share of the travel allocation. It should also be acknowledged that remote monitoring is another mechanism used to address risk exposure.

Pages 18-19

- **CPD monitoring goals may not be consistent with program risk.**

Comment 23 Once again, if the report is going to cite a possible weakness the auditor should be able to say with some assurance, based on an appropriate level of testing, that monitoring goals are, or are not, consistent with program risk. The assumption made is that they may not be consistent with risk.

Comment 24 The auditor states that in reviewing goals, it would appear officials believe that formula grantees pose the greatest risk. The auditor further writes that this may not be true. For support, the Chief of HUD’s Budget Management and Systems Division in the Office of the Chief Financial Officer (CFO) is quoted. The official quoted is neither an employee of CPD, nor a subject matter expert on CPD’s programs or monitoring practices.

Comment 25 CPD officials steadfastly believe that formula grantees pose the greatest risk considering the fact that about 84 percent of all annual CPD program funding goes to them. Only 16 percent is reserved for competitive grants. Some non-profits can be

risky entities due to limited capacity, but the dollar value of the risk is much less significant than in formula program.

Page 19

- **CPD should consider prior year monitoring findings in establishing future year monitoring goals.**

Comment 26

Prior year monitoring findings are considered for formula grantees as part of the annual risk analysis process. It is part of the each formula program's risk analysis assessment sheet under the factor "Management" and part entitled "On-Site Monitoring." For the competitive programs, which receive only 16 percent of our program funds, capacity is one of the factors considered in the funding process.

Pages 19-20

- **CPD performs minimal on-site monitoring.**

Comment 27

This is a false statement lacking supporting evidence. Our level of on-site monitoring since FY 1999 has been, and continues to be, at a high level. First, during FY 2003, CPD on-site monitored 690 competitive (consisting of 552 Continuum of Care grantees and 138 non-homeless grantees) and 442 formula grantees. These numbers enabled us to exceed our FY 2003 goal of monitoring 35 percent of formula grantees, 20 percent of Continuum of Care grantees and 7 percent of non-homeless competitive grantees.

Comment 28

Second, it is stated, "While these percentages (referred to above) may seem relatively high, it is important to note that the required monitoring is a percentage of the number of grantees, not grants. Accordingly, the percentage of grants monitored will be significantly lower." This is a false assumption. The number of grants monitored will not be significantly lower, or necessarily lower for that matter. This is because the auditor apparently incorrectly concluded for this analysis that only one grant is reviewed during an on-site visit to a grantee. In actuality, we typically cover one to four grants per on-site visit. Oddly enough, the auditor seemed to recognize this fact in the last paragraph on page 26 when they wrote "whether it reviews one formula grant or four," but limited it to one in coming up with the percentage of grants monitored on-site figure.

Comment 29

This false assumption is also apparent in the chart on page 20 of the audit report entitled "CPD's FY 2003 Monitoring Goals" where the auditor concluded that only 18 percent of formula grants were monitored. This assumption is based on the determination that we had a total of 2,195 formula grants (from the chart) in FY 2003 and performed 400 (1,143 x 35 and narrative at the top of page 20. Since it is incorrectly assumed that we reviewed only one grant per grantee visit, instead of the one to four

that is typically covered, the conclusion was incorrectly reached that we reviewed only 18 percent (400/2,195) of the grants.

Comment 30 The same incorrect assumption was used in determining the level of Continuum of Care grants that were monitored. In the above referenced chart the auditor reported that only 7 percent of these grants were monitored. This is based on the assumption that we had 7,000 Continuum of Care grants (from the chart) in FY 2003 and performed 520 (2,600 x 20 percent) on-site visits, also taken from the chart. Since it was incorrectly assumed that we reviewed only one grant per visit, the false conclusion was reached that we reviewed only 7 percent (520/7,000) of the grants.

Comment 31 The report also does not recognize the fact that CPD conducts remote monitoring, which is identical to on-site monitoring, except that it takes place without traveling to the entity. CPD field offices use remote monitoring based on the risk analysis process. As stated in the Departmental Management Control Program, HUD Handbook 1840.1 Rev. 3, this can serve to validate the soundness of the rating criteria, as well as possibly obtaining early warnings of potential serious problems. The results of remote monitoring are handled in the same manner as on-site monitoring.

Page 21

Comment 32 **Despite the reduced travel funds, the field offices still plan to exceed the national monitoring goals for formula and competitive, non-homeless grants, but they do not plan to meet the national goals for the competitive homeless grants.**

This projection is incorrect, as the results of on-site monitoring visits performed during FY 2003 proved otherwise. The original national goals for on-site monitoring visits during FY 2003 were exceeded in all three of the above program categories, including competitive homeless grants as shown below.

<u>Type of Program</u>	<u>Original Goal</u>	<u>Actual Visits</u>
Formula	417	442
Competitive – Homeless	534	552
Competitive – Non-homeless	124	138

The method used for counting visits creates a disincentive for comprehensive monitoring reviews.

Comment 33 This statement is problematic on several levels. First, what is the basis for the OIG’s perception that “comprehensive monitoring reviews” are required? All monitoring follows the Departmentally mandated risk analysis process. It is not clear that “comprehensive monitoring” is even defined in Handbook 1840.1, Rev-3 (see especially section 7-9). Therefore, the underlying premise for the criticism is invalid and inconsistent with Departmental policy.

Comment 34 Notwithstanding this misrepresentation, the OIG's lack of supporting evidence to show instances where CPD's methodology for counting visits created any disincentives (let alone detected nonprofit capacity problems!) transforms this into an unsubstantiated opinion, without factual basis. The Department does not dictate any methodology that requires a tallying of grants monitored versus grantees. CPD's monitoring strategies are driven by the risk scores and the relative weight of the sub factors for each grantee; these entities, and the individual CPD grants within their portfolio, are targeted for monitoring accordingly. Because funds are awarded to grantees, the GMP system is set up on this basis to consistently account for grantee monitoring and management.

Page 25 - 26

- **CPD lacks a supportable basis for requesting additional resources.**

Comment 35 The initial REAP study conducted in 2001 was flawed. Only 2 out of 42 CPD field offices were reviewed in that study. There were problems in determining essential tasks during the first REAP study, not because CPD didn't know what those tasks were, but because of the unempirical manner in which the study was announced and conducted. As mentioned, the REAP refresh, which covered six field offices and headquarters, gives a better picture of our essential tasks and staffing needs based on essential tasks.

Comment 36 The auditor's statement that the new REAP study is unlikely to resolve the question of whether CPD has sufficient staff is faulty. The recently completed REAP refresh study will help to resolve the question of whether CPD has sufficient staff. CPD has determined what workload activities are essential to our operations. We also reject the quote included in the report from the Chief of the Budget Management and Systems Division, Office of the CFO. He is not a CPD employee and no evidence is provided by the auditor in support of the statement.

Page 26

- **CPD's methodology for counting monitoring visits creates a disincentive for comprehensive monitoring.**

Comment 37 As stated above, the OIG's premise regarding "comprehensive" monitoring is inconsistent with Departmental policy and the report provides no factual basis for this opinion.

Page 27

- **While CPD's risk assessment process appears to be a sound basis for allocating limited resources, CPD has not tested the process. Accordingly, its actual effectiveness at identifying high-risk grantees is unknown.**

- Comment 38 This statement is not only without merit, but appears to significantly migrate from the Congressional request. It leaps from faint praise that CPD has a risk assessment process to a criticism that CPD's failure to test would somehow overlook an identification of "high risk" grantees. What does this have to do with assessing the capacity of nonprofits? What evidence does the OIG base its conclusion on? As stated above, monitoring low risk grantees in and of itself constitutes a testing of the process, according to Handbook 1840.1 Rev-3 (see section 7-6.B). And how does the OIG draw the conclusion that a high-risk grantee is high risk solely based on capacity?
- Comment 39 Notwithstanding the irrelevance of this text, the fact remains that CPD has used an approved risk analysis process (Notice CPD-02-11, dated 12/31/02) in FYs 2003 and 2004. The Notice was recently reissued with some revisions as a result of an in-house management analysis of the results. This evaluation process is an ongoing function of CPD's stewardship of its funds and we will continue to review, assess, and revise, as necessary and appropriate.
- Comment 40 *OIG Note: The remainder of CPD's response is not included because it pertained to a draft finding that was removed from our final report and therefore no longer applicable. See Comment 40 for additional details.*

OIG Evaluation of Auditee Comments

The following are HUD OIG's comments on the February 1, 2004 letter from the General Deputy Assistant Secretary for CPD.

1. The decision to limit the review to CPD was made by OIG management based on a preliminary assessment of HUD's programs and prior audit work. As stated in the report, since CPD does not have management controls unique to nonprofits, it was necessary for us to assess the management controls over all grantees and subgrantees. We did not arbitrarily expand the scope.
2. CPD information systems cannot provide CPD's universe of funded entities. Further, we did not need to determine the universe of funded entities in order to satisfy our audit objectives.
3. The report discusses the differences between CPD's formula and competitive programs in the Executive Summary and addresses the controls separately as applicable throughout the report.
4. Our providing a definition of capacity does not invalidate the report. We did this to provide the users of this report with a basic understanding of the term. CPD does not have any definitions of capacity for their formula programs even though legislation specifically refers to capacity. For their competitive programs, CPD lacks a single definition but defines capacity through the quality ranking factors contained in the Notices of Funding Availability. OIG's definition of capacity is consistent with CPD's ranking factors.
5. The report is based on the premise, consistent with the relevant statutes, which recipients of CPD funds need a base amount of capacity in order to successfully carry out CPD programs. As noted in the report, applicable legislation is ambiguous concerning the extent to which Congress intended CPD to consider capacity in funding formula grantees.
6. Government auditing standards do not require extensive testing to support report findings. Paragraph 7.14 of the standards state, "Auditors can obtain an understanding of internal control through inquiries, observations, inspection of documents and records, or reviews of other auditor's reports."
7. We revised the caption in the left margin to state, "Capacity is not a factor used to allocate formula grants." However, as noted in the report, applicable legislation is ambiguous concerning the extent to which Congress intended CPD to consider capacity in funding formula grantees.

The evaluation of technical assistance was beyond the scope of our audit.

8. We revised the caption in the left margin to state, “CPD has the option of terminating funding for grantees shown to lack capacity.” The report addresses termination of funding as a management control available to CPD to prevent funding an entity with known capacity problems. The report does not express a preference for termination over other available corrective actions.
9. See Comment 8, above.
10. The report does not express any opinion on the effectiveness of CPD’s enforcement actions.
11. This statement was removed from the report. However, as noted in the report, applicable legislation is ambiguous concerning the extent to which Congress intended CPD to consider capacity in funding formula grantees.
12. See Comment 7, above.
13. Government auditing standards do not require the use of statistical sampling. We have provided additional examples of both formula and competitive grantees with capacity issues within the report and in Appendix D. In addition, while the Section 108 and EDI programs are not formula grants, the City of Atlanta is a formula grantee. Accordingly, capacity problems within the City of Atlanta are relevant.
14. See Comments 4 and 6.
15. CPD has not provided guidance for all of its formula programs and guidance for the CDBG Program, its largest program, is outdated.
16. The Monthly Status Report on HOME Deadline Requirements as described by CPD is a monitoring tool for CPD to use after grant funds have been provided. The report would not assist grantees in evaluating the capacity of prospective subgrantees prior to funding.
17. SNAPSHOT is used by CPD internally to identify grantees that are behind in certain performance indicators; however, it is not used by grantees to evaluate the capacity of subgrantees.
18. We added examples from prior OIG audit reports of grantees that lacked capacity (see pages 13 and 14, and Appendix D).
19. The HUD Reform Act does not prohibit CPD from verifying the accuracy of information provided by the applicant. Specifically, 24 CFR Part 4.26(b)(2) states an authorized employee, during the selection process, may contact an applicant for the purpose of clarification of the terms of the applicant’s application.

CPD has not documented the risks associated with inaccurate applications or determined the related costs of verifying application data.

20. We acknowledge CPD's efforts in improving its monitoring functions to date; however, CPD needs to further improve management controls to ensure monitoring is adequate.
21. CPD field offices use the risk analysis process to select grantees for monitoring. CPD does not use the risk analysis process to establish its nationwide monitoring goals.
22. CPD could not provide any documentation to show that its annual monitoring goals were consistent with program risk.
23. See Comment 22.
24. The Chief, while not a CPD employee, has a lengthy tenure with HUD and possesses special knowledge of CPD through his oversight of the REAP studies. Nevertheless, we removed the quote from the report.
25. See Comment 22.
26. The paragraph referenced by CPD was removed from the report.
27. The report discussion relates to monitoring goals, not actual monitoring performed. CPD goals only require on-site monitoring of a small percentage of grants. Further, CPD reduced its monitoring goals in FY 2004 to 25 percent of formula grantees and 15 percent of competitive grantees.
28. CPD monitoring goals only require the field offices to monitor one grant per on-site visit. The report acknowledges that the field offices may choose to monitor additional grants. See Comment 29.
29. The table referred to by CPD contains a footnote that states the following, "The column represents the minimum amount of monitoring required to meet the goals. Field offices are not precluded from monitoring more than one grant per grantee."
30. See Comment 29.
31. CPD did not track remote monitoring performed during our audit period. At the exit conference, the Director of the Office of Field Management stated they were initiating a remote monitoring pilot program for fiscal year 2004.
32. The report is based on how CPD establishes goals for monitoring, and is not intended to provide information on actual monitoring performed.
33. The paragraph referred to in CPD's comments was removed from the report.

34. The paragraph referred to in CPD's comments was removed from the report. However, we found that CPD does not consider the number of grants, subgrantees, or high-risk areas reviewed by the field offices when accounting for on-site monitoring visits.
35. The paragraph referred to in CPD's comments was removed from the report.
36. The paragraph referred to in CPD's comments was removed from the report.
37. See Comment 34.
38. CPD field offices use the risk analysis process to select grantees for on-site monitoring. Accordingly, the process is relevant to our objective of evaluating CPD's oversight processes. Further, the May 2004 REAP Study of CPD Field Offices contained Business Process Improvement Areas. Improvement areas included a revision of the risk analysis criteria to "more accurately reflect the risk of a grantee" and a revision of the scoring system to provide a more meaningful assessment of grantee risk.
39. See Comment 38.
40. We included a finding in our draft report regarding weaknesses in CPD's information systems that limit their usefulness as management tools in the monitoring process. We removed the finding from the final report. As part of our ongoing audit planning process, OIG will consider performing a more in-depth review of the Grants Management Process (GMP) system at a later date as audit resources permit.