



Issue Date	March 30, 1999
Audit Case Number	99-CH-156-0001

TO: Cardell Cooper, Assistant Secretary for Community Planning and Development, D

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

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

We completed a multi-location audit of the Office of Community Planning and Development's oversight of the Empowerment Zone Program. The objective of our audit was to determine whether HUD has an effective system for oversight and control of the Program. We performed the audit based upon our Fiscal Year 1998 annual audit plan. The audit was conducted at HUD Headquarters, four Empowerment Zones, and HUD's State Offices of Community Planning and Development having jurisdiction for the four Zones we reviewed. The four Zones were Atlanta, Chicago, Detroit, and Philadelphia.

We concluded that HUD did not have an adequate system of oversight and control for the Empowerment Zone Program. HUD did not effectively assess the progress and status of the Empowerment Zones. The Headquarters' EZ/EC Team did not confirm the appropriateness of the use of Empowerment Zone funds, nor did it confirm that the use of funds complied with the Cities' Strategic Plans. The Team also did not ensure that Performance Reviews submitted by the Cities were verified for accuracy. As a result, HUD did not detect that Empowerment Zone resources were not always efficiently and effectively used, and the impression exists that the benefits of the Empowerment Zone Program were greater than actually achieved.

Within 60 days, please provide us, for each recommendation made in this report, 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. Also, please provide us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (312) 353-7832.

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# Executive Summary

We completed a multi-location audit of HUD's Office of Community Planning and Development's oversight of the Empowerment Zone Program. The objective of our audit was to determine whether HUD has an effective system for oversight and control of the Program. We performed the audit based upon our Fiscal Year 1998 annual audit plan. The audit was conducted at HUD Headquarters, four Empowerment Zones, and HUD's State Offices of Community Planning and Development having jurisdiction for the four Zones we reviewed. The four Zones were Atlanta, Chicago, Detroit, and Philadelphia.

We concluded that HUD did not have an adequate system of oversight and control for the Empowerment Zone Program. HUD did not effectively assess the progress and status of the Empowerment Zones. The Headquarters' EZ/EC Team did not confirm the appropriateness of the use of Empowerment Zone funds, nor did it confirm that the use of funds complied with the Cities' Strategic Plans. The Team also did not ensure that Performance Reviews submitted by the Cities were verified for accuracy. As a result, HUD did not detect that Empowerment Zone resources were not always efficiently and effectively used, and the impression exists that the benefits of the Empowerment Zone Program were greater than actually achieved.

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## HUD's Controls For Assessing Empowerment Zones Were Not Adequate

HUD's Headquarters EZ/EC Team did not effectively assess the status and progress of Empowerment Zones. The Team did not confirm the appropriateness of the use of Empowerment Zone funds. The Team also did not confirm that the Zones' activities complied with the respective Strategic Plans regarding the use of Zone funds. All four Empowerment Zones we reviewed inappropriately used some of their Zone funds, and two of the Zones did not materially comply with their Strategic Plans regarding the use of Zone funds. The Headquarters EZ/EC Team did not have: (1) adequate controls to ensure Zones were promptly assessed upon completion of the Performance Reviews; (2) adequate procedures to confirm that Zone funds were used according to Empowerment Zone Program guidelines; and (3) adequate controls and procedures to ensure corrective actions were initiated for problems identified during the Performance Review process.

## HUD Did Not Verify The Accuracy Of Performance Reviews Submitted By The Cities

HUD did not verify the accuracy of the Performance Reviews submitted by the Cities for the Empowerment Zone Program. The four Cities we reviewed provided inaccurate information to HUD for 61 of the 64 activities (95.3 percent) we evaluated from the June 30, 1997 Performance Reviews. The Cities inaccurately reported the actual status and progress for 35 of the activities and incorrectly reported 26 projects as Empowerment Zone activities when they

were not. Additionally, two Cities overstated the amount of estimated leveraged funding by over \$143 million (a 535 percent error rate) and \$460 million (an 18 percent error rate), respectively. The problems occurred because HUD did not have procedures and controls to ensure Performance Reviews were verified for accuracy. Instead, HUD relied on the Cities to accurately report the accomplishments of their Empowerment Zone Programs. However, the Cities did not have adequate controls over their Performance Reviews to accurately report to HUD.

Recommendations

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

During the audit, we presented our draft findings to HUD's Coordinator of the EZ/EC Initiative and our draft audit report to the Assistant Secretary for Community Planning and Development. We held an exit conference with the Coordinator on January 25, 1999. HUD provided written comments to our draft report. The comments generally disagreed with the scope, methodology, and conclusions of our review. However, in our opinion, the comments provided no substantive information or documentation to cause us to change our conclusions or recommendations. The complete text of the comments are included in Appendix B with the exception of five attachments that were not necessary for understanding HUD's comments.

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# Introduction

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

The Empowerment Zone Program was authorized by the Omnibus Budget Reconciliation Act of 1993. The Reconciliation Act authorized the Secretary of HUD to designate six urban areas as Empowerment Zones. In December 1994, the former Secretary of HUD designated areas in Atlanta, Baltimore, Chicago, Detroit, New York, and Philadelphia/Camden as urban Empowerment Zones. The length of the designations was limited to 10 years. The Reconciliation Act provided funding for the Empowerment Zone Program under Title 20 of the Social Security Act. The Program was designed to provide \$250 million in tax benefits and \$100 million of Social Services Block Grant funds from the Department of Health and Human Services.

HUD's former Secretary also designated two urban areas as supplemental Empowerment Zones in December 1994. The two areas were in the Cities of Cleveland and Los Angeles. The two Cities were provided funding through HUD's Economic Development Initiative grant as supplemental Zones. The Taxpayer Relief Act of 1997 authorized the two supplemental Zones to receive tax benefits as provided under the Omnibus Reconciliation Act of 1993. The Taxpayer Relief Act also established the District of Columbia as an Empowerment Zone and authorized the Secretary of HUD to designate 15 additional urban areas as Empowerment Zones.

On January 13, 1999, HUD's Secretary named 15 economically distressed communities as new Empowerment Zones. This makes them eligible, along with five new rural Zones, to share \$3.8 billion in proposed Federal grants and tax-exempt bonding authority to finance revitalization and job creation over the next 10 years. The new urban Zones are:

- Boston, Massachusetts
- Cumberland County (Bridgeton/Vineland), New Jersey
- Cincinnati, Ohio
- Columbia/Sumter, South Carolina
- Columbus, Ohio
- El Paso, Texas
- Gary/East Chicago, Indiana
- Knoxville, Tennessee
- Miami, Florida
- Minneapolis, Minnesota
- New Haven, Connecticut
- Norfolk/Portsmouth, Virginia
- Santa Ana, California
- St. Louis, Missouri/East St. Louis, Illinois
- Huntington, West Virginia/Ironton, Ohio

The Omnibus Reconciliation Act of 1993 authorized the Secretary of HUD to issue regulations needed to administer and oversee the Empowerment Zone Program. HUD’s regulations for the Program are located at 24 CFR Part 597. The regulations require HUD to periodically determine whether the Empowerment Zones should continue with their designations based upon information received from the Zones, verify the accuracy of the information received from the Zones, approve activities submitted by the Zones, and coordinate technical assistance when requested or a need is identified. The Department of Health and Human Services disburses Empowerment Zone funds to the States and resolves questions concerning the permissible use of Zone funds. HUD and the Department of Health and Human Services are required to ensure that Empowerment Zone funds are used efficiently and effectively. Previously HUD used outside contractors, called generalists, to assist the Cities in implementing their Strategic Plans. As of September 1996, the Secretary’s Representatives and the State Coordinators assumed the functions previously performed by the generalists. The day-to-day oversight of the Empowerment Zone Program is performed by staff in HUD’s EZ/EC Initiative Office at Headquarters. The EZ/EC Initiative Office is part of HUD’s Office of Community Planning and Development.

HUD is currently implementing its 2020 Management Reform Plan. The Plan was established to improve HUD’s operations and to correct outstanding management deficiencies. Currently, the Plan does not contain specific details related to the Empowerment Zone Program. HUD’s Coordinator of the EZ/EC Initiative said HUD plans to include specific provisions in the Plan to address the Empowerment Zone Program.

The following table shows the amount of Empowerment Zone funds that had been drawn down for the original six Empowerment Zones as of December 31, 1998:

Empowerment Zone	Funding
Atlanta	\$ 9,919,148
Baltimore	18,789,000
Chicago	12,981,027
Detroit	8,139,778
New York	10,450,447
Philadelphia/Camden	<u>21,712,509</u>
<b>Total</b>	<b><u>\$81,991,909</u></b>

Audit Objective

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

Audit Scope And Methodology

We performed our on-site work between February and November 1998 at HUD Headquarters, four Empowerment Zones, and the respective State Offices of Community Planning and Development for the four Zones. The four



Zones were the Cities of Atlanta, Chicago, Detroit, and Philadelphia. We previously issued separate audit reports for each of the four Zones we reviewed. The report numbers and issue dates for the four Zones' reports are:

<b>Zone</b>	<b>Report Number</b>	<b>Issue Date</b>
<b>Atlanta</b>	98-CH-259-1005	September 28, 1998
<b>Chicago</b>	99-CH-259-1002	October 15, 1998
<b>Detroit</b>	99-CH-259-1003	October 20, 1998
<b>Philadelphia</b>	98-CH-259-1006	September 30, 1998

Our review did not include the Camden portion of the Philadelphia/Camden Empowerment Zone, since Philadelphia and Camden were administered separately, Camden had reported few accomplishments, and the bulk (\$79 million) of Zone funds was awarded to Philadelphia.

To determine whether HUD had an effective system for oversight and control for the Empowerment Zone Program, we interviewed staff at: HUD Headquarters and the State Offices of Community Planning and Development, the Department of Health and Human Services, the four Zones, and the organizations that administered the four Zones' activities. Based upon the activities' funding and reported accomplishments, we judgmentally selected and evaluated 64 of the four Zones' 389 activities reported in the June 30, 1997 Performance Reviews. Appendix A contains the activities reviewed for each of the four Zones.

To evaluate HUD's oversight and control for the Empowerment Zone Program, we reviewed records maintained by the four Zones, the administering entities, HUD Headquarters, and HUD's Offices of Community Planning and Development. We reviewed: the Omnibus Budget Reconciliation Act of 1993; the Taxpayer Relief Act of 1997; HUD's guidance and instructions for the Program; the four Zones' June 1997 Performance Reviews, files, reports, and approved payment requests related to the activities; and the administering entities' voucher payments, monitoring files, and supporting documentation.

The audit covered the period July 1, 1996 to June 30, 1997. This period was adjusted as necessary. We conducted our audit in accordance with generally accepted government auditing standards.

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

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# HUD's Controls For Assessing Empowerment Zones Were Not Adequate

HUD's Headquarters EZ/EC Team did not effectively assess the status and progress of Empowerment Zones. The Team did not confirm the appropriateness of the use of Empowerment Zone funds. The Team also did not confirm that the Zones' activities complied with the respective Strategic Plans regarding the use of Zone funds. All four Empowerment Zones we reviewed inappropriately used some of their Zone funds; two of the Zones did not materially comply with their Strategic Plans regarding the use of Zone funds. As part of the June 1997 Performance Review process, HUD's State Offices of Community Planning and Development provided their conclusions on the status and progress of the Empowerment Zones to the EZ/EC Initiative Office. The State Offices reported that three of the four Zones we reviewed were not making adequate progress. The Headquarters EZ/EC Team did not use the information provided by the State Offices to initiate corrective actions.

Since the lack of progress or the failure to comply with the Strategic Plans may be grounds for HUD to revoke an Empowerment Zone's designation, corrective actions needed to be expeditiously taken. The problems occurred because the Headquarters EZ/EC Team did not have: (1) adequate controls to ensure Zones were promptly assessed upon completion of the Performance Reviews; (2) adequate procedures to verify that Zone funds were used according to Empowerment Zone Program guidelines; and (3) adequate controls and procedures to ensure corrective actions were initiated for problems identified during the Performance Review process. As a result, HUD lacks assurance that the Cities were efficiently and effectively using their Empowerment Zone resources.

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## HUD's Requirements

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

24 CFR Part 597.403(a)(2)(3) says the Secretary may revoke the designation of an urban Empowerment Zone if the Secretary determines, on the basis of the periodic performance review, that the local government in which the urban area is located: has failed to make progress in achieving the benchmarks set forth in the strategic plan; or has not complied substantially with the strategic plan.

HUD's Guidance for the 1997 EZ/EC Performance Review System dated August 22, 1997, page 6, required the Headquarters EZ/EC Team to evaluate the performance of the Empowerment Zones and determine whether to continue an individual Zone designation based upon information from the Field Office review, interviews with the Secretary's Representative, State reports, the Department of Health and Human Services' Title 20 Social Services Block Grant drawdown reports, and other information.

HUD Lacked Adequate Controls To Assess Zones

HUD's Headquarters EZ/EC Team did not have adequate controls that ensured the Empowerment Zones were promptly assessed and a determination made on whether their designations should continue. The latest Performance Reviews for the Empowerment Zones were completed as of June 1997; however, as of November 30, 1998, the Team had not used the information from the Performance Review process to complete an assessment. HUD's Coordinator of the EZ/EC Initiative said the assessments of the Empowerment Zones' progress, as reported in the June 30, 1997 Performance Reviews, were not conducted because his staff was busy planning for the second round of Zone designations. HUD does not now plan to assess the Zones June 1997 Performance Reviews.

As part of the Performance Review process, HUD's State Offices of Community Planning and Development reported to the Headquarters EZ/EC Team that the Atlanta, Detroit, and Philadelphia Zones were making little or no progress in carrying out their Strategic Plans. For example, the Pennsylvania State Office of Community Planning and Development's analysis of the Philadelphia Empowerment Zone dated September 22, 1997 showed the City was not making suitable progress. The State Office reported that most of the economic development activities, the most notable accomplishments of the Philadelphia Empowerment Zone, were funded by HUD's Community Development Block Grant program and would have taken place without the Zone's support. However, the Headquarters EZ/EC Team did not complete an assessment for continuing eligibility based on the June 1997 Performance Review, and the information provided by the State Office.

Since the lack of progress in carrying out the Strategic Plan is grounds for HUD to revoke a Zone's designation, the

conclusions reached by HUD's State Offices should have prompted the Headquarters EZ/EC Team to take action on the lack of progress by the Zones. 24 CFR Part 597.402(a) states "HUD will make findings on the continuing eligibility for and the validity of the designation of any Empowerment Zone". This establishes the requirement for the Headquarters EZ/EC Team to assess a Zone's progress and recommend continuing a designation based on the Performance Reviews. 24 CFR Part 597.403(b)(1)(ii) says "the Secretary will issue a letter of warning to the nominating State and local government advising that the Secretary has determined that the nominating local government and/or State is not complying substantially with, or has failed to make progress in achieving the benchmarks set forth in the strategic plan".

Additionally, page 4 of the Cities and the States Memorandum of Agreements with HUD says "HUD may revoke the designation of an urban area as an Empowerment Zone if it is determined, on the basis of the periodic performance review, that the urban area has failed to make progress in achieving the benchmarks set forth in the strategic plan or has not complied substantially with the Strategic Plan. Such revocation shall be preceded by a letter of warning".

Based upon HUD's regulation, the Memorandum of Agreements, and the information submitted to the Headquarters EZ/EC Team by HUD's State Offices of Community Planning and Development, the EZ/EC Team should have issued warning letters to the Cities of Atlanta, Detroit, and Philadelphia to take corrective action or face the possibility of losing their designations as Empowerment Zones due to the lack of progress toward their Strategic Plans. Because HUD's EZ/EC Team did not complete an assessment of the Empowerment Zones based on information provided as a result of the June 1997 Performance Review process, it did not issue any warning letters to the Empowerment Zones or initiate corrective actions such as providing technical assistance to address the lack of progress.

During our audit, HUD was in the process of implementing a new Empowerment Zone Program performance measurement system which included new procedures for assessing the Zones' progress. HUD's Coordinator said he planned to develop written procedures to assess the Zones' progress and continuing designations by April 1999.

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

HUD’s Headquarters EZ/EC Team did not have adequate procedures to ensure Zone funds were appropriately used according to Empowerment Zone Program guidelines. The Team did not conduct reviews of the Cities to determine whether Empowerment Zone funds were efficiently and effectively used. Instead, the Team requested information regarding the use of Zone monies from the Department of Health and Human Services. The Department of Health and Human Services relied on the States’ monitoring reviews for its information.

We determined that the States of Illinois, Michigan, and Pennsylvania did not perform on-site monitoring reviews to determine if Zone funds were appropriately used. The State of Georgia performed reviews that assessed the appropriateness of some administrative expenditures from Zone funds. However, none of the four States performed on-site reviews to determine if expenditures benefited Zone residents. The States believed they needed to ensure requests for Empowerment Zone funds were for Strategic Plan activities. The States did not believe they were required to perform on-site monitoring reviews to verify that Zone funds were used according to the Strategic Plans, and benefited Empowerment Zone residents.

42 USC Section 1397f(c)(1)(C) says “an area shall use the grant for activities that benefit residents of the area for which the grant is made”. 24 CFR Part 597.200(f) also says “activities included in the plan may be funded from any source, Federal, State, local, or private, which provides assistance in the nominated area”. The Federal law and HUD’s regulation do not provide a definition of benefit to Zone residents. HUD’s Coordinator of the EZ/EC Initiative said as long as an Empowerment Zone activity used Zone funds to benefit one Zone resident, the activity met the requirement to serve Zone residents. In our opinion, the Coordinator’s definition does not provide an adequate basis to ensure the efficient and effective use of Empowerment Zone funds. Based on the Coordinator’s definition, if only \$1 of Zone funds benefit Zone residents, the Empowerment Zone Program objective is met.

Because of the lack of a statutory or regulatory definition of “benefit to Zone residents” and because we believe the

HUD Coordinator's definition fails to adequately meet the intent of the Empowerment Zone Program, we developed our own measurement. We used a definition that an activity did not benefit Empowerment Zone residents if the activity served less than 51 percent of Zone residents, or if the activity did not benefit Zone residents when the activity's administrator had control over who received the benefit. We believe our definition appropriately establishes a minimum measurement of whether Empowerment Zone funds benefited Zone residents and still provides the Cities with the flexibility in the use of Zone funds. The activities' administrators at the four Zones' we reviewed had full control over who received the benefit of their services.

The Cities of Chicago and Philadelphia used Empowerment Zone funds that did not benefit Zone residents and did not comply with their Strategic Plans regarding the use of Zone funds. The City of Detroit also used Zone funds that did not benefit Zone residents and did not comply with their Strategic Plan; however, the amount was very small (\$2,879). The City of Atlanta complied with its Strategic Plan, but used Zone funds that did not benefit Zone residents and violated Federal law. The following table shows the results of our review of activities at Chicago, Philadelphia, and Atlanta that caused us to conclude that the expenditure of funds was inappropriate.

	Chicago	Philadelphia	Atlanta
<b>Zone Activities Reviewed</b>	11	7	7
<b>Activities Violating Strategic Plan</b>	7	3	0
<b>Zone Funds Used/Committed</b>	\$2,797,623	\$184,594	\$3,283,331

<b>Zone Funds Misspent/ Inappropriately Committed</b>	\$634,246	\$83,998	\$1,576,419
<b>Percent of Zone Funds Misspent/ Inappropriately Committed</b>	22.7%	45.5%	48.0%
<b>Unsupported Zone Funds Used</b>	\$847,484	\$32,934	\$0
<b>Percent of Unsupported Zone Funds Used</b>	30.3%	17.8%	0%

As shown in the table, the Cities of Chicago, Philadelphia, and Atlanta inappropriately used/committed or did not have documentation to support the use of between 48 and 63 percent of their Empowerment Zone funds. We consider Chicago and Philadelphia’s inappropriate use of Zone funds to be a strong indicator of substantial non-compliance with their Strategic Plans. HUD’s Program guidelines require, at a minimum, letters of warning to be issued to ensure corrective actions are immediately taken. Although Atlanta’s use of funds was according to its Strategic Plan, we believe the large amount of funds that the City used/committed that did not benefit the Zone, required HUD to initiate corrective actions and provide technical assistance.

Because HUD did not adequately define its responsibility in assessing the appropriateness of fiscal expenditures for the Empowerment Zone Program, it did not have adequate procedures and controls to ensure the use of Empowerment Zone funds was appropriate. The lack of confirmed funding information limited HUD’s ability to effectively assess the Cities’ Empowerment Zone Programs.

HUD Did Not Assure Corrective Action Was Taken By The Zones

HUD did not have adequate controls and procedures to ensure corrective actions were taken when problems were identified with Empowerment Zones. HUD’s State Offices of Community Planning and Development identified problems with the Atlanta, Detroit, and Philadelphia Empowerment Zones during the analysis of the June 1997 Performance Reviews. For example, on November 19, 1997, the Michigan State Office of Community Planning



and Development reported that half of the Detroit Empowerment Zone's projects showed no progress. The Office said the cause was attributable to: (1) inexperienced staff at the Detroit Empowerment Zone Development Corporation, which the City contracted with to administer its Empowerment Zone Program; and (2) insufficient computer capability.

Since the Headquarters EZ/EC team never completed its assessment, no corrective actions were initiated or technical assistance provided. The City of Detroit's response to our audit findings dated September 21, 1998 still reported the lack of adequate computer equipment and inexperienced staff at the Detroit Empowerment Zone Development Corporation as the cause for the inaccurate reporting and the inappropriate use of Zone funds. As a result, HUD lacks assurance that the Empowerment Zone Program was operated efficiently and effectively and that problems that have been identified were adequately addressed.

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#### Auditee Comments

Excerpts paraphrased from the Coordinator of the EZ/EC Initiative's comments on our draft report follow. Appendix B, page 53, contains the complete text of the comments.

The OIG did not understand the nature of the Initiative and employed questionable scope and methodology in its audit.

#### OIG Evaluation of Auditee Comments

The OIG understands the Empowerment Zone Program was established to rebuild communities in poverty-stricken inner cities and rural areas by developing and implementing strategic plans. We evaluated HUD's oversight of the Program by conducting audit work at HUD Headquarters, four Empowerment Zones, and the respective State Offices of Community Planning and Development for the four Zones. We interviewed staff at: HUD Headquarters and the State Offices of Community Planning and Development, the Department of Health and Human Services, the four Zones, and the administering entities of the four Zones' activities. We also selected and evaluated 64 of the four Zones' 389 activities reported in the June 1997 Performance Review. We selected the activities that the Zones reported had the most progress and expenditure of funds. We believe our scope and methodology provided a sound basis on which to draw our conclusions.

Auditee Comments

It appears the OIG failed to realize that HUD funds are not a major source of funding for the EZ/EC Initiative. The OIG imposed its own policy preferences.

OIG Evaluation of  
Auditee Comments

The OIG acknowledges that HUD funds are not the main source of funding for the Empowerment Zone Program. However, according to the Code of Federal Regulations, HUD and the Department of Health and Human Services have dual responsibilities to assure Empowerment Zone funds are used efficiently and effectively. This information was considered in planning and performing the audit.

To evaluate HUD's oversight of the Empowerment Zone Program, we used 42 USC Section 1397f(c)(1)(C) that says "an area shall use the grant for activities that benefit residents of the area for which the grant is made" and Section 1397f(c)(1)(B) that says "an area shall use the grant in accordance with the strategic plan for the area".

We also used HUD's own regulation (24 CFR Part 597.401) that says "HUD will regularly evaluate the progress of the strategic plan in each designated Empowerment Zone on the basis of performance reviews to be conducted on site and other information submitted", and HUD's August 22, 1997 Guidance for the 1997 EZ/EC Performance Review System, page 6, which states "the Headquarters EZ/EC Team combines information from the Field Office assessment, interviews with the Secretary's Representatives, State reports, the Department of Health and Human Services Title 20 Social Services Block Grant drawdown reports, and other information to evaluate the performance of the Empowerment Zones and whether to continue an individual Zone designation".

The Federal law and HUD's regulation do not provide a definition of benefit to Zone residents. HUD's Coordinator of the EZ/EC Initiative said as long as an Empowerment Zone activity used Zone funds to benefit one Zone resident, the activity met the requirement to serve Zone residents. In our opinion, the Coordinator's definition does not provide an adequate basis to ensure the efficient and effective use of Empowerment Zone funds. Based on the Coordinator's definition, if only \$1 of Zone funds benefit Zone residents, the Empowerment Zone Program objective is met.

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Because of the lack of a statutory or regulatory definition of “benefit to Zone residents” and because we believe the HUD Coordinator’s definition fails to adequately meet the intent of the Empowerment Zone Program, we developed our own measurement. We used a definition that an activity did not benefit Empowerment Zone residents if the activity served less than 51 percent of Zone residents, or if the activity did not benefit Zone residents when the activity’s administrator had control over who received the benefit. We believe our definition appropriately establishes a minimum measurement of whether Empowerment Zone funds benefited Zone residents and still provides the Cities with the flexibility in the use of Zone funds. The activities’ administrators at the four Zones’ we reviewed had full control over who received the benefit of their services.

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#### Auditee Comments

We agree with the Philadelphia Inquirer which referred to the OIG’s review as a drive-by audit and stated that the OIG’s look at Empowerment Zones lacks substance. The Inquirer went on to say that the OIG’s findings smacked of nitpicking, and its release, just before a second round of funding for Empowerment Zones was authorized, hinted of politics.

#### OIG Evaluation of Auditee Comments

We believe the Philadelphia Inquirer misconstrued or misunderstood the objectives and scope of our audit at the four Zones. The objectives were to determine whether the Cities: (1) efficiently and effectively used Empowerment Zone funds to meet the objectives of their Strategic Plans; and (2) accurately reported the accomplishments of their Empowerment Zone Programs to HUD. In assessing the Cities’ Empowerment Zone Programs, we used their June 1997 Performance Reviews. At the time of our audit, the 1997 Reviews were the most current Program results that had been reported by the Cities.

We evaluated 64 of the 389 (16.5 percent) activities reported by the four Empowerment Zones in the June 1997 Performance Reviews. We found the Performance Reviews grossly misrepresented the accomplishments of the Programs. Three of the four Zones inappropriately used/committed or lacked documentation to support the use of over \$3.5 million (42.9 percent) of Empowerment Zone funds reviewed. We also determined the four Zones inaccurately reported: (1) the actual status and progress of 61 (95.3 percent) activities; and

(2) 26 projects as Empowerment Zone activities when they were not. The Chicago and Detroit Zones incorrectly reported their leveraged funds by over \$143 million (a 535 percent error rate) and \$460 million (an 18 percent error rate), respectively. We believe the reporting errors and the weak oversight of the Empowerment Zone Program as described in this report, are significant and in need of corrective actions.

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**Auditee Comments**

The draft report misconstrues the nature of the EZ/EC Initiative. Congress authorized the Department of Health and Human Services to provide the bulk of Federal assistance to the Empowerment Zones and Enterprise Communities through the Omnibus Budget Reconciliation Act of 1993. The authorizing statute requires that all projects funded in whole or in part with Social Services Block Grant funds must attempt to produce some benefit for residents of the designated neighborhoods.

**OIG Evaluation of  
Auditee Comments**

Our report does not misconstrue the nature of the Empowerment Zone Program. Contrary to the Coordinator of the EZ/EC Initiative's comments, the statute (42 USC Section 1397f(c)(1)(C) and Section 1397f(c)(1)(B)) does not include language saying all projects funded in whole or in part with Social Services Block Grant funds must attempt to produce some benefit for residents of the designated neighborhoods. Rather, 42 USC Section 1397f(c)(1)(C) says "an area shall use the grant for activities that benefit residents of the area for which the grant is made" and Section 1397f(c)(1)(B) says "an area shall use the grant in accordance with the strategic plan for the area".

Additionally, 24 CFR Part 597.200(ii) says "Empowerment Zone funds must be used to achieve or maintain the goals of the strategic plan". The Zones' Strategic Plans required Empowerment Zone funds to be used to benefit Zone residents. For example, the City of Chicago's Strategic Plan regarding the 21<sup>st</sup> Century Community Learning Centers, pages 68 and 69, says "we wish to increase the capabilities of Empowerment Zone residents to prepare for jobs in fast growth industries, and within Zone neighborhoods, programs will be built around local schools, transforming them into true community centers focused on lifelong learning".

During our audits of the four Empowerment Zones, we determined Zone funds were used to benefit non-Zone

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residents and were not used according to the Zones' Strategic Plans. For example, the City of Chicago inappropriately used \$114,755 of Zone funds to establish Community Learning Centers outside of the Zone. HUD needs to establish procedures and controls to ensure Empowerment Zone funds are used to benefit Zone residents according to the Cities' Strategic Plans.

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#### Auditee Comments

HUD's primary role in monitoring the expenditure of Empowerment Zone and Enterprise Community funds is quite different from the role of the Department of Health and Human Services, States, Cities, and the Zones and Communities. HUD ensures that the funds are spent according to an Empowerment Zone's or Enterprise Community's Strategic Plan and approves projects and programs prior to implementation to ensure they benefit residents. HUD reviews all projects and programs against the relevant Strategic Plan prior to approving their implementation; thereby, ensuring that residents of the designated area will benefit from the activities.

#### OIG Evaluation of Auditee Comments

During our audits of the four Empowerment Zones, we determined that HUD did not ensure Zone funds were used to benefit Zone residents or were used according to the Zones' Strategic Plans. For example, the City of Chicago inappropriately used \$148,622 of Zone funds for the Job Link Program to provide non-Zone residents with job placement services and skills training. The City's Strategic Plan and Job Link's contract required the services to be provided to Zone residents; neither document made reference to services to be provided to non-Zone residents. The City of Chicago's Strategic Plan, page 48, says the Job Link Program will "link businesses and community-based organizations with job development and training projects to meet the needs of Zone residents". Job Link's contract, page 3, says "all services shall be provided for the primary benefit of residents of the census tracts which comprise the Empowerment Zone".

We acknowledge HUD is responsible for reviewing and approving projects and programs submitted by the Zones; however, HUD's approval does not ensure the funds are used according to the Zones' Strategic Plans. HUD needs to establish procedures and controls to ensure that Zones use their funds according to the Strategic Plans and to benefit Zone residents.

Auditee Comments

The OIG fails to recognize the nature and structure of the EZ/EC Initiative. The draft report faults HUD's EZ/EC Initiative Office for shortcomings that are not part of the Department's role in the Initiative. The report claims that the Department did not have adequate controls to assess the Empowerment Zones. This finding is based upon the artificial and illegitimate standards for evaluating the appropriate use of Empowerment Zone and Enterprise Community resources set forth by the OIG. The draft report asserts that individual Zone activities were inappropriate unless 51 percent or more of the activities' beneficiaries were Empowerment Zone residents. The OIG should note that the EZ/EC Initiative differs from the Community Development Block Grant program which applies the 51 percent rule.

OIG Evaluation of  
Auditee Comments

The OIG recognizes the nature and structure of the Empowerment Zone Program and did not fault HUD for actions that were outside its responsibility. HUD is required to ensure that Zone funds are used according to the Cities' Strategic Plans. 42 USC Section 1397f(c)(1)(C) says "an area shall use the grant for activities that benefit residents of the area for which the grant is made" and Section 1397f(c)(1)(B) says "an area shall use the grant in accordance with the strategic plan for the area". Additionally, 24 CFR Part 597.200(ii) says "Empowerment Zone funds must be used to achieve or maintain the goals of the strategic plan". The Federal law and HUD's regulations do not define benefit to Zone residents.

As noted previously, because of the lack of a definition of the term 'benefit to Zone residents', we developed our own measure of Zone benefit for audit purposes. We believe the measure is consistent with the intent of the Empowerment Zone Program.

For example, the City of Philadelphia used \$83,310 of Empowerment Zone funds for the Lead Abatement Program to provide lead abatement services to five properties; however, only one of the properties was located in the Zone. The City's Strategic Plan regarding the Program, page 15, says "through a project designed to compliment the City's newly HUD-funded Lead Paint Hazard Reduction Program, a lead containment strategy will be implemented. This will permit systematic work in creating a lead-safe

environment within the Zone”. Additionally, the City incorrectly reported in its June 1997 Performance Review that the Lead Abatement Program served 800 Zone households when it only served a total of five properties, only one of which was located in the Zone.

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### Auditee Comments

The OIG’s method of selection of Empowerment Zones and individual activities is not adequately explained in the draft report. The OIG audited four Zones during the course of its review. Nowhere does the draft report address the basis for selecting the entities to be audited. Why were not any Enterprise Communities reviewed? The draft report does not explain this imbalance. Why these Zones rather than others? Once again, the draft report provides no answers. However, OIG staff told us that the four Zones were selected in part because of the negative press they had received. If true, the selection process raises serious concerns. Anecdotal evidence from negative press accounts does not form an appropriate basis for selecting the sites for a fair and balanced audit. The comments of OIG staff leave the impression that entities were selected in order to skew the audit with as many negative findings as possible. The draft report also does not adequately explain the selection of activities for review. The report states that these activities were judgmentally selected.

### OIG Evaluation of Auditee Comments

We selected the four Empowerment Zones from the six original Zones. Two Zones, Detroit and Philadelphia, were selected based upon reportedly positive accomplishments, and the other two Zones, Chicago and Atlanta, were selected because they reportedly were experiencing problems. At the four Zones, we judgmentally selected 64 of the 389 activities reported in the June 30, 1997 Performance Reviews. The activities that had the greatest expenditure of funds and reported accomplishments were selected. The audit did not address Enterprise Communities because the audit objective was limited to an evaluation of HUD’s oversight of the Empowerment Zone Program.

The OIG did not skew the selection of Zones to identify as many negative findings as possible. As previously stated, two Zones were selected because of reportedly positive accomplishments. We believe our selection criteria resulted in a fair and balanced audit approach.

Auditee Comments

he draft report incorrectly describes the type of actions Empowerment Zone or Enterprise Community. The OIG activities based on unfounded conditions that run afoul of

Auditee Comments

24 CFR Part 597.402(a) states “HUD will make findin continuing eligibility for and the validity of the designation of Guidance for the 1997 EZ/EC Performance Review System, information from the Field Office assessment, interviews with of Health and Human Services Title 20 Social Services Block drawdown reports, and other information to evaluate the continue an individual Zone designation”. Our audit June 30, 1997 Performance Reviews were submitted to HUD.

activities based upon the Federal law, HUD’s regulation, and says “an area shall use the grant for activities that benefit Part 597.200(f) also says “activities included in the plan may be provides assistance in the nominated area”. However, we funds to benefit Zone residents.

Warren/  
A, says “establish and implement a system which provides east region of the Empowerment Zone”. Additionally, the the Coalition is a “community-based family service program chronically unemployed into gainful employment through a address the issue of job accessibility. This effort is also a model



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great promise for turning around the lives of the people of the Zone.” Although the Strategic Plan indicated the program was targeted to Zone residents, the City used \$2,879 of Zone funds to provide 82 persons with child-care services of which 61 (74 percent) were non-Zone residents.

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#### Auditee Comments

HUD had adequate controls to assess the Empowerment Zones and take corrective actions. The draft report incorrectly described HUD’s monitoring responsibility. HUD used the information submitted by the Empowerment Zones and Enterprise Communities to evaluate the progress of the Zones and Communities. The draft report’s mistaken evaluation in this area seemed to be predicated on a judgment that HUD should undertake formal evaluations of the Empowerment Zones and Enterprise Communities on an annual basis. Implementing laws and regulations do not contain a requirement for an annual review.

#### OIG Evaluation of Auditee Comments

In our opinion, HUD did not have adequate controls to assess the Zones and take corrective action. Although Performance Reviews were submitted by the Zones, HUD did not perform an assessment of the 1997 Reviews as its own August 1997 Guidance said would be done. HUD did not initiate actions to address problems identified by the State Directors of Community Planning and Development in their evaluations of the Zones’ Performance Reviews. We acknowledge that HUD is not required to perform an annual assessment. Our finding does not question the lack of an annual assessment, but that an assessment was not performed once the June 30, 1997 Performance Reviews were received as required by HUD’s regulation and the August 22, 1997 Guidance.

24 CFR Part 597.401 says “HUD will regularly evaluate the progress of the strategic plan in each designated Empowerment Zone on the basis of performance reviews to be conducted on site and other information submitted”. Additionally, HUD’s August 22, 1997 Guidance for the 1997 EZ/EC Performance Review System, page 6, says “the Headquarters EZ/EC Team combines information from the Field Office assessment, interviews with the Secretary’s Representatives, State reports, the Department of Health and Human Services Title 20 Social Services Block Grant drawdown reports, and other information to evaluate the performance of the Empowerment Zones and whether to continue an individual Zone designation”. The

EZ/EC Team could not provide any documentation to show that it used the Performance Reviews to evaluate the Zones' progress.

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### Auditee Comments

It should be noted that the draft report erroneously states that HUD did not perform an assessment of the progress of the Philadelphia Empowerment Zone. The Coordinator of the EZ/EC Initiative Office visited the Philadelphia Zone to discuss performance-related issues on several occasions. Based upon this dialogue and the Philadelphia Zone's continuing efforts to improve its performance, the EZ/EC Office determined that punitive action, such as a letter of warning, would have been counterproductive.

The EZ/EC Office also took actions directed to individual Zones. The 1997 Performance Reviews, in conjunction with the field office assessments, were used to identify and address management troubles at the Philadelphia Empowerment Zone. Based on these findings, the EZ/EC Office asked the Philadelphia Zone to file a new Performance Review. The Office then contacted the Secretary's Representative and the Office of the Mayor to enlist help in addressing the findings of the reviews and assessments. The OIG's failure to include information regarding these actions and similar actions in Atlanta and Detroit in the draft report is deeply troubling.

The draft report's recommendation that a letter of warning be issued in this situation is ill-advised. The EZ/EC Initiative Office only should take such an action when warranted. The report also is skewed by incomplete representations of the factual record. The draft report seizes upon portions of field office assessments of the Atlanta, Detroit, and Philadelphia Empowerment Zones at the expense of a balanced presentation. The report does not identify those activities on which the Zones were making progress.

### OIG Evaluation of Auditee Comments

In our opinion, the audit report correctly states that HUD did not perform an assessment of the four Zones using the June 30, 1997 Performance Reviews. We did not mention any corrective actions that the Coordinator of the EZ/EC Initiative indicated were taken at Philadelphia, Atlanta, and Detroit because the actions were not evident and the Coordinator

could not provide documentation to support that corrective actions had occurred.

HUD's own regulation 24 CFR Part 597.403(b)(1)(ii) says "the Secretary will issue a letter of warning to the nominating State and local government advising that the Secretary has determined that the nominating local government and/or State is not complying substantially with, or has failed to make progress in achieving the benchmarks set forth in the strategic plan". Therefore, we believe our recommendation to issue warning letters to the Philadelphia, Atlanta, and Detroit Zones for their failure to make progress in meeting their Strategic Plans is appropriate.

We find it difficult, to comment on activities on which the Zones were making progress, when the Zones' own reported accomplishments were so grossly misrepresented as noted in our reports. In addition, HUD's own Offices of Community Planning and Development cited the Philadelphia, Atlanta, and Detroit Empowerment Zones for lack of progress.

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## Auditee Comments

The draft report mistakenly criticizes HUD for its procedures regarding the appropriate use of Zone funds. The report's conclusion regarding HUD's fiscal oversight seems to be based upon both a misconception of HUD's statutory role and the unduly narrow interpretation of appropriate activities. The Department of Health and Human Services has primary fiscal responsibility for the Social Services Block Grants.

The Department of Health and Human Services and the States, not HUD, have the responsibility for oversight of Social Services Block Grant funds and they have sound reasons for applying standards and reporting requirements that are more flexible and consistent with the Initiative's goals and objectives than the misguided standards and requirements applied by the OIG.

## OIG Evaluation of Auditee Comments

42 USC Section 1397f(c)(1)(C) says "an area shall use the grant for activities that benefit residents of the area for which the grant is made", and Section 1397f(c)(1)(B) says "an area shall use the grant in accordance with the strategic plan for the area". Additionally, 24 CFR Part 597.200(ii) says "Empowerment Zone funds must be used to achieve or

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597.200(f) also says “activities included in the plan may be funded from any source, Federal, State, local, or private, which

As previously mentioned, we found the Zones did not always use their Empowerment Zone funds to benefit Zone residents.

with its Strategic Plan, HUD cannot ignore how Zone funds are expended. Our audit found that HUD did not ensure Zones

were inappropriately used. While the Department of Health and Human Services has the primary fiscal responsibility, HUD

effectively. Our audit is not suggesting that any new reporting standards be imposed on the States or the Cities. All Federal

funds are efficiently and effectively used. This includes HUD.

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The OIG’s criticism of the Atlanta Empowerment Zone centered on the Atlanta Center for Home Ownership

OIG’s conclusion that fewer than 51 percent of individuals that benefited from the Program were

of the people served. Many of the non-Zone residents served by the Program expressed an interest in finding

typically had the same low-income profile as Empowerment Zone residents. The OIG also used an invalid calculation to

The OIG assumed that the percentage of Empowerment Zone residents served was the percentage of the total of the

expended. The OIG’s mistaken calculation had the affect of

100 percent Zone residents served and completely ignored the role of start-up costs. Accordingly, the of the Atlanta Empowerment Zone is unreliable.

Our criticism of the Atlanta Empowerment Zone is based on

funds. We found the Atlanta Zone inappropriately used/committed over \$1.6 million of Zone funds related to four

OIG Evaluation of  
Auditee Comments

activities. Of the \$1.6 million, \$793,157 was related to the Atlanta Center for Home Ownership.

42 USC Section 1397f(c)(1)(C) says “an area shall use the grant for activities that benefit residents of the area for which the grant is made”. 24 CFR Part 597.200(f) also says “activities included in the plan may be funded from any source, Federal, State, local, or private, which provides assistance in the nominated area” Additionally, the Center’s contract, page 1, says “the Center will emphasize support services for money management, home management, home ownership, and provide in depth personalized assistance to Empowerment Zone residents”.

As previously noted, HUD’s Coordinator of the EZ/EC Initiative said as long as an Empowerment Zone activity used Zone funds to benefit one Zone resident, the activity met the requirement to serve Zone residents. In our opinion, the Coordinator’s definition does not provide an adequate basis to ensure the efficient and effective use of Empowerment Zone funds. Based on the Coordinator’s definition, if only \$1 of Zone funds benefit Zone residents, the Empowerment Zone Program objective is met.

Because of the lack of a statutory or regulatory definition of “benefit to Zone residents” and because we believe the HUD Coordinator’s definition fails to adequately meet the intent of the Empowerment Zone Program, we developed our own measurement. We used a definition that an activity did not benefit Empowerment Zone residents if the activity served less than 51 percent of Zone residents, or if the activity did not benefit Zone residents when the activity’s administrator had control over who received the benefit. We believe our definition appropriately establishes a measurement of whether Empowerment Zone funds benefited Zone residents and still provides the Cities with the flexibility in the use of Zone funds. The activities’ administrators at the four Zones’ we reviewed had full control over who received the benefit of their services.

In regard to the Atlanta Center for Home Ownership, since only 18.9 percent of the individuals served were Zone residents, we concluded that the Center did not primarily benefit Empowerment Zone residents. While the profile of non-Zone residents served may be similar to Zone residents,

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residents.

The method we used to calculate the per person cost included provide services. Start up costs were included because they were a part of operating the Program. Since the Center had with the terms of its contract by serving more Zone residents.

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### Auditee Comments

The draft report incorrectly holds HUD accountable for the the Department will work to ensure that all entities involved in the Initiative understand and implement their monitoring

It is misleading for the OIG to criticize HUD for not having Empowerment Zone funds because the statutes and regulations governing the funds make it clear that HUD is has controls to ensure that Empowerment Zone and Enterprise Community funds are spent according to the fulfill HUD's monitoring role without overstepping its responsibility as prescribed by law. The draft report does

### OIG Evaluation of

The OIG does not hold HUD accountable for the fiscal responsibility of the States. However, HUD indicated that it and effectively. Our audit found that none of the four States conducted reviews to ensure funds were appropriately used by to ensure Zone funds are used appropriately.

Our audit found that HUD did not have adequate controls to with the Cities' Strategic Plans and to the benefit of Zone residents. Three of the four Zones we reviewed did not funds and all four Zones used Zone funds to serve non-Zone residents. HUD's responsibility regarding the appropriate use

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**Auditee Comments**

The EZ/EC Office disagrees with recommendation 1A. The EZ/EC Office has adequate controls to assess the progress toward the Strategic Plans. The draft report's finding and recommendation is unfounded. The EZ/EC Office monitors such progress on an ongoing basis and performs formal assessments when appropriate.

**OIG Evaluation of Auditee Comments**

In our opinion, HUD did not have adequate controls to assess the Zones. Although Performance Reviews were submitted by the Zones, HUD did not perform an assessment of the 1997 Reviews as its own regulation and August 1997 Guidance required.

24 CFR Part 597.401 says "HUD will regularly evaluate the progress of the strategic plan in each designated Empowerment Zone on the basis of performance reviews to be conducted on site and other information submitted". Additionally, HUD's August 22, 1997 Guidance for the 1997 EZ/EC Performance Review System, page 6, says "the Headquarters EZ/EC Team combines information from the Field Office assessment, interviews with the Secretary's Representatives, State reports, the Department of Health and Human Services Title 20 Social Services Block Grant drawdown reports, and other information to evaluate the performance of the Empowerment Zones and whether to continue an individual Zone designation". HUD could not provide any documentation to show that it used the Performance Reviews to evaluate the Zones' progress. As a result, HUD needs to establish controls to assess a Zone's progress toward its Strategic Plan immediately following the receipt of the Zone's Performance Reviews.

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**Auditee Comments**

The EZ/EC Office agrees with recommendations 1B and 1D. The Office is in the process of implementing a new EZ/EC Performance Measurement System that will improve reporting by the Empowerment Zones and Enterprise Communities. The EZ/EC Office also is working with field offices to verify the results of the most recent annual reports submitted by the Zones and the Communities. Further, the Office is creating manuals for the policies and procedures related to the EZ/EC Initiative as well as developing training for Community Builders, Public Trust Officers, and designees to ensure they understand and properly implement

OIG Evaluation of  
Auditee Comments

the policies and procedures. Taken together, these measures will improve current procedures and controls and

The actions proposed by HUD for recommendation 1B should improve the accuracy of activities' reported funding levels, if include proposed actions to address recommendation 1D. HUD needs to establish procedures and controls to take problems are identified.

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OIG Evaluation of  
Auditee Comments

The EZ/EC Office disagrees with [draft] recommendations taking action against particular Zones are based upon mistaken findings and are inappropriate. The EZ/EC Office Zones make progress toward their Strategic Plans.

At the time of our audit, HUD had not assessed the Zones' required by HUD's own regulation. 24 CFR Part 597.402(a) states "HUD will make findings on the continuing eligibility for

This establishes the requirement for the Headquarters EZ/EC Team to assess a Zone's progress and recommend continuing a the Directors of Community Planning and Development for the Atlanta, Detroit, and Philadelphia Empowerment Zones cited

Performance Reviews. HUD's own regulation 24 CFR Part 597.403(b)(1)(ii) says "the Secretary will issue a letter of that the Secretary has determined that the nominating local government and/or State is not complying substantially with, or forth in the strategic plan".

Although we believe that our conclusions are valid, the EZ/EC Empowerment Zone based solely on our audit report. Consequently, we have revised draft audit recommendations



to assess the four Cities' progress toward implementing their Plans and implement appropriate corrective measures. If a City is found not making the necessary progress, then HUD should issue a warning letter to the City based upon the lack of progress.

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## Recommendations

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

- 1A. Establishes controls to assess an Empowerment Zone's progress toward its Strategic Plan immediately following the receipt of the Zone's Performance Reviews.
- 1B. Establishes procedures and controls to confirm the accuracy of funding information received regarding the use of Empowerment Zone funds.
- 1C. Formally assess the progress of the Cities of Atlanta, Detroit, Chicago, and Philadelphia Empowerment Zones toward implementing their Strategic Plans, and implement appropriate corrective measures. If the Cities are found not making the necessary progress, then HUD should issue warning letters to the Cities based upon the lack of progress as required.
- 1D. Establishes procedures and controls which will assure corrective action is taken when problems are identified in the implementation of the local Empowerment Zone Program.
- 1E. Establishes a definition of benefit to Empowerment Zone residents with the Department of Health and Human Services to ensure the efficient and effective use of Zone funds.



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## HUD Did Not Verify The Accuracy Of Performance Reviews Submitted By The Cities

HUD did not verify the accuracy of the Performance Reviews submitted by the Cities for the Empowerment Zone Program. The four Cities we reviewed provided inaccurate information to HUD for 61 of the 64 activities (95.3 percent) we evaluated from the June 30, 1997 Performance Reviews. The Cities inaccurately reported the actual status and progress for 35 of the activities and incorrectly reported 26 projects as Empowerment Zone activities when they were not. Additionally, two Cities overstated the amount of estimated leveraged funding by over \$143 million (a 535 percent error rate) and \$460 million (an 18 percent error rate), respectively. The problems occurred because HUD did not have procedures and controls to ensure Performance Reviews were verified for accuracy. Instead, HUD relied on the Cities to accurately report the accomplishments of their Empowerment Zone Programs. However, the Cities did not have adequate controls over their Performance Reviews to accurately report to HUD. As a result, HUD did not have accurate information to assess the Zones' progress on meeting the goals of their Strategic Plans. The impression also exists that the benefits of the Empowerment Zone Program were greater than actually achieved.

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### HUD's Requirements

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

HUD's Empowerment Zone/Enterprise Communities Review Policy Guidance dated June 14, 1996, page 5, says State Offices of Community Planning and Development should verify the accuracy of the reports by reviewing selected projects on-site. The on-site review may be conducted anytime during the year and in conjunction with visits to the cities for other monitoring and evaluation purposes.

HUD's Guidance for the 1997 EZ/EC Performance Review System dated August 22, 1997, page 1, states the primary responsibility for the assessment of the 1997 Performance Reviews lies with the State Directors of Community Planning and Development. The Directors are responsible for conducting the initial assessment of the Reviews. Page 3 of the guidance restates the requirements for HUD to conduct on-site evaluations of the Performance Reviews as required by 24 CFR Part 597.401.

HUD Did Not Verify The Accuracy Of Performance

HUD’s State Offices of Community Planning and Reviews for the four Empowerment Zones we examined. The four Zones were the Cities of Atlanta, Chicago, accurately report the accomplishments of their Empowerment Zone Programs; however, we found that the Performance Reviews to accurately report to HUD. Of the 64 activities we reviewed from the June 30, 1997 actual status, funding, and progress for 35 of the activities and incorrectly reported 26 projects as Empowerment Zone remaining activities was correctly reported to HUD. The following table summarizes the most common inaccuracies

Empowerment	<u>Inaccurately Reported Information</u>		
	Measures	Funding	
Atlanta	4		2
Chicago		9	6
	7	8	
Philadelphia	<u>7</u>	—	<u>8</u>
Totals	—	<u>30</u>	<u>19</u>

Reported Performance

reviewed contained inaccuracies regarding the performance measures of 27 activities. Performance measures are the final outcomes of the activity. For example, the City of Philadelphia’s June 1997 Performance Review showed that the households located in its Empowerment Zone. However, the Program’s administering entity provided documentation that 1997. The City also did not report that jobs were created as a result of the loan to the administering entity. The entity’s employees were hired as of June 30, 1997. Of the 15 employees hired, three were Empowerment Zone residents.

Since HUD's State Offices of Community Planning and Reviews, the inaccurate reporting of the performance measures was not identified.

Were Inaccurate

levels for 30 activities in the June 1997 Performance Reviews. Funding consists of Empowerment Zone Federal funds, State and local funds, private donations, and in-kind contributions. The Performance Reviews showed the 30 showed the actual funding level was only \$24,701,522 as of June 30, 1997. The net effect was an over reporting of summarizes the funding level overstatements by each Zone.

<i>Empowerment Zone</i>	<i>Activities</i>	<i>Reported</i>	<i>Supported</i>	<i>Reported</i>
	3		\$1,228,000	
<b>Chicago</b>		7,902,290		2,228,052
	8		8,967,840	
<b>Philadelphia</b>		49,682,243		40,850,799
	<u>30</u>	<u>                    </u>	<u>\$24,701,522</u>	<u>                    </u>

For example, the City of Atlanta's June 1997 Performance Courier leveraged \$700,000 in private funds. Our review of funds were not received as of June 30, 1997. HUD's Development did not verify the information before using it its September 29, 1997 analysis of the 1997 Performance EZ/EC Team that the Corporate Courier Loan leveraged accurate information to assess the Zones' progress on of the three activities for which the City of Atlanta

Reported Performance  
Milestones Were  
Inaccurate

The June 1997 Performance Reviews for the four Zones we reviewed contained inaccuracies regarding the performance milestones of 19 activities. Performance milestones are the key interim actions that will result in the completion of the activity. For example, the City of Chicago’s June 30, 1997 Performance Review failed to report the progress made on the Employer Assisted Housing Program’s milestones. The City’s 1997 Review showed the Program had not identified any financial institutions to participate in the Program. However, the Program’s administering entity provided documentation that showed it identified a participating institution in March 1997. Although HUD’s August 22, 1997 Guidance required it to verify the accuracy of the Zones’ June 1997 Performance Reviews, HUD did not establish procedures and controls to ensure Reviews were verified by on-site visits. As a result, HUD did not discover the inaccurate reporting.

Activities Were  
Incorrectly Reported As  
Zone Activities

HUD did not verify that the Empowerment Zones accurately reported projects as Empowerment Zone activities. The 1997 EZ/EC Performance Review instructions issued by HUD on June 23, 1997, page 3, says “the template should also be used to report other activities, endorsed by the governing structure, that are not included in your formal benchmarks but are being implemented to benefit the Empowerment Zone. For example, such actions might include businesses that have expanded while using the tax incentives, but that are not individually benchmarked”. In the June 1997 Performance Reviews, the four Zones we examined incorrectly reported 26 projects as Zone activities when the activities were not initiated or expanded as a result of the Cities’ Empowerment Zone designations.

The incorrect reporting of non-Zone activities as Empowerment Zone activities overstates the impact of the Empowerment Zone Program. The commingling of Zone and other activities which were initiated prior to the start of the Empowerment Zone Program overstates the actual impact of the Program. Since HUD did not determine that the 26 activities were incorrectly reported, the Performance Reviews showed the Empowerment Zone Program leveraged a total of \$77,821,609 when it did not. The following table shows the number of activities and corresponding leveraged funds that were incorrectly reported.

Empowerment Zone	Number of Activities	Funding
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Atlanta	9	\$57,204,000
Chicago	15	7,205,909
Detroit	1	8,956,200
Philadelphia	<u>1</u>	<u>4,455,500</u>
Totals	<u>26</u>	<u>\$77,821,609</u>

For example, the City of Atlanta's June 1997 Performance Review showed that the Sidewalk Repair and Storm Drainage Improvements projects were Empowerment Zone activities. However, the projects were scheduled prior to the City's Zone designation. HUD's Georgia Office reported that various infrastructure improvements included in Atlanta's June 30, 1997 Performance Review, such as the Sidewalk Repair and the Storm Drainage projects, were the result of efforts made by the Corporation for Olympic Development in Atlanta and were made independent of Atlanta's Empowerment Zone staff or Board. However, HUD's Georgia Office did not request the City to justify the inclusion of the activities as Empowerment Zone projects.

The former Deputy Director of the Georgia State Office of Community Planning and Development said her Office did not request the City's justification because HUD's guidance only required them to analyze information provided by the City and report the analysis to the Headquarters EZ/EC Team for the Team's follow-up. Although the State Office correctly reported that the infrastructure improvements were made independent of the Empowerment Zone, it did not exclude the reported leveraged funds from its analysis. HUD's Headquarters EZ/EC Team did not take any action based upon the Georgia State Office's analysis.

Leveraged Funding Was Overstated By More Than \$600 Million

Two of the four Empowerment Zones overstated the estimated amount of leveraged funding in the June 1997 Performance Reviews. The two Zones were the Cities of Chicago and Detroit.

The 1997 Performance Review showed that Chicago's 84 Empowerment Zone activities should leverage \$176.1 million. However, supporting documentation included with the Review showed the 84 activities would only leverage \$36.6 million, a difference of \$139.5 million. In addition, the \$36.6 million was not accurate.

The City of Chicago sent a survey to 49 of the 84 Empowerment Zone activities to confirm the status and funding source information for the 1997 Performance Review. The City could not explain why the survey was not sent to all 84 activities. Thirty-eight of the 49 Zone activities submitted confirmations to the City. We reviewed the City's confirmations and determined that they showed different funding amounts than those that were included in the City's June 1997 Performance Review. We determined that the \$36.6 million was overstated by \$3.7 million. As a result, the City overstated the amount of leveraged funds by \$143.2 million (\$139.5 million + \$3.7 million), an error rate of 535 percent.

HUD's Illinois State Office of Community Planning and Development used the information without verifying it as a basis for its analysis of the Chicago Empowerment Zone's performance. The Illinois State Office's progress report dated November 7, 1997 showed that \$43 million of Empowerment Zone funds would leverage \$176 million from public and private agencies.

The City of Detroit also overstated the amount of estimated leveraged funds in its June 1997 Performance Review. The Review's Executive Summary estimated that the City's 73 Empowerment Zone activities should leverage over \$3 billion. However, supporting documentation included with the Review showed the 73 activities would leverage \$2.54 billion. The net effect was an overstatement of leveraged funds by over \$460 million, an error rate of 18 percent. As occurred with HUD's Illinois State Office, HUD's Michigan State Office of Community Planning and Development did not verify the accuracy of the information before it used the information in its analysis of the City of Detroit's Empowerment Zone.

HUD Did Not Have  
Procedures And Controls  
To Verify The Reviews

The inaccuracies in the June 1997 Performance Reviews occurred because HUD's State Offices of Community Planning and Development did not have procedures and controls to verify the accuracy of the Reviews. HUD's Coordinator of the EZ/EC Initiative agreed that HUD needed to improve its verification process. He said HUD relied on the Cities to



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accurately report the accomplishments of their Empowerment Zones to HUD. While HUD's State Offices of Community Planning and Development performed monitoring reviews of other programs administered by the four Cities, they did not conduct any on-site reviews to verify the accuracy of the information reported in the Cities' 1997 Performance Reviews.

HUD's Director of Community Planning and Development at the Pennsylvania State Office said there were no accomplishments by the Philadelphia Empowerment Zone to review. However, the City of Philadelphia reported in the 1997 Performance Review that all of its Zone activities were completed. HUD's Director of Community Planning and Development for the Michigan State Office said she did not verify the accuracy of information reported on Detroit's Empowerment Zone Program since the funding did not come from HUD. She said she made the decision to devote her resources to reviewing programs where HUD's funding was at risk. The former Program Advisor for HUD's Illinois State Office of Community Planning and Development said he believed site visits were encouraged but not mandatory. The Community Planning and Development Director for HUD's Georgia State Office said he had not been delegated the authority to monitor Zone activities or verify the accuracy of Atlanta's 1997 Performance Review.

Although each of HUD's State Offices had a different reason for not verifying the information reported by the four Cities, we believe HUD's instructions regarding verification were clear. On June 14, 1996, HUD issued guidance that required State Offices of Community Planning and Development to verify the accuracy of Performance Reviews by examining selected projects on-site. However, the Headquarters EZ/EC Team had no procedures to assure the State Offices followed the guidance. Because the information was not verified, HUD did not have accurate information to assess the Zones' progress on meeting the goals of their Strategic Plans and the impression exists that the benefits of the Empowerment Zone Program were greater than actually achieved.

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### Auditee Comments

Excerpts paraphrased from the Coordinator of the EZ/EC Initiative's comments on our draft report follow. Appendix B, page 53, contains the complete text of the comments.

The draft report evidences a highly questionable scope and methodology of the review of the EZ/EC Initiative. There is simply no explanation of the basis for the OIG's selection of individual Zones and activities to audit. The draft report fails to offer any explanation of the statistical relevance of the 64 activities reviewed out of a total of more than 2,000 engaged nationwide by the Initiative. The report also does not provide a satisfactory explanation for the selection of the particular 64 activities out of the 389 carried out by the four Zones audited by the OIG.

OIG Evaluation of  
Auditee Comments

We selected the four Empowerment Zones from the six original Empowerment Zones. Two Zones, Detroit and Philadelphia, were selected based upon reportedly positive accomplishments, and the other two Zones, Chicago and Atlanta, were selected because they were reportedly experiencing problems. At the four Zones, we judgmentally selected 64 of the 389 activities reported in the June 30, 1997 Performance Reviews. The activities that had the greatest expenditure of funds and reported accomplishments were selected. We did not use statistical sampling techniques for the audit nor did we attempt to project our review results to the entire universe. The Coordinator of the EZ/EC Initiative's comments regarding the relationship between the 64 activities reviewed to a total of more than 2,000 activities nationwide is not relevant since only 389 of the more than 2,000 activities related to the four Zones reviewed.

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Auditee Comments

The draft report inappropriately assumes that legitimate activities must occur exclusively within the physical confines of the Empowerment Zone, be funded with Initiative resources, and asserts that activities begun prior to a Zone designation are not reportable as Zone activities. These standards demonstrate the OIG's narrow view of the EZ/EC Initiative.

OIG Evaluation of  
Auditee Comments

We did not question the Cities' reporting of activities based upon the activities' location. We only questioned the Cities' reporting of activities that were not initiated or expanded because of the Cities' Zone designation, or if the activities' benefits to Zone residents could not be supported. In order to properly evaluate the impact of the Empowerment Zone Program, HUD must have reliable data on the actual accomplishments of the Cities' Programs. The commingling of Zone and other activities which were initiated prior to the start

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of the Empowerment Zone Program overstates the actual impact of the Program.

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### Auditee Comments

The OIG fails to present the statistical relevance of the selected activities for the individual Cities reviewed. The OIG reviewed 16 of 123 activities in Atlanta, 26 of 84 activities in Chicago, 10 of 73 activities in Detroit, and 12 of 109 activities in Philadelphia. The number of activities selected at each site does not correspond to the overall number of activities for the site nor is there any explanation for the divergent levels of review of each Zone.

The draft report also fails to explain anomalies such as the failure to review a single activity in Camden even though such activities make up approximately one-fifth of the 109 activities of the Philadelphia Empowerment Zone. Consistent with generally accepted government accounting standards, the OIG must include a disclaimer in its report that the sample of activities reviewed is not sufficient to draw conclusions about the Program as a whole.

### OIG Evaluation of Auditee Comments

As previously stated, our sample was not statistical. Initially, we judgmentally selected 10 activities from each City that had reported the greatest expenditure of funds and progress. We expanded the sample as appropriate on the basis of information that became available during the review. The sample size was adequate to draw our conclusions. The error rate that we encountered at each location was significant, indicating that corrective actions are required to improve the Program.

The portion of the Philadelphia Zone that related to Camden was not included in this review because preliminary information indicated Camden had few results to review and the bulk of the funds were for Philadelphia. In addition, the Philadelphia and Camden Zones were each administered separately. The Camden Zone's results could not be used to evaluate the administration of the Philadelphia Zone. The Philadelphia Zone could not be used to evaluate the administration of the Camden Zone. We clearly stated this fact in our entrance conference with the Coordinator of the EZ/EC Initiative. We adjusted our report to include this information.

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Auditee Comments

One of the unique aspects of the EZ/EC Initiative is its reliance on performance measurement to ensure that local implementation efforts are a success. The HUD EZ/EC Office works closely with the Empowerment Zones and Enterprise Communities to ensure that they fully understand the principles of performance measurement and the importance of accurate reporting. In fact, the EZ/EC Office currently is working to implement a new Performance Measurement System to improve the understanding of Zones and Communities and the accuracy of reporting.

OIG Evaluation of Auditee Comments

The HUD EZ/EC Office did not ensure the accuracy of Empowerment Zones' reporting. In fact, the review disclosed an error rate of over 95 percent for the activities we reviewed at the four Zones. The actions planned by HUD to implement a new reporting system should correct the problem, if HUD establishes procedures and controls to verify the accuracy of the information reported.

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Auditee Comments

The draft report's support for finding two is plagued by inaccuracies and a misunderstanding of the design and purposes of the Initiative. The report vastly overstates the level of inaccurate reporting by the four Zones. The OIG applied standards to the Empowerment Zones' Performance Reviews that are both unfounded and misguided. The draft report maintains that activities scheduled prior to an Empowerment Zone or Enterprise Community designation or funded by means other than Zone or Community funds should not be reported. These limitations are imposed over and above the OIG's mistaken standards for judging benefit to Zone residents and the permissible locations for activities. Neither the statutes nor the regulations impose these limitations on the Empowerment Zones and Enterprise Communities. Instead, each of the Zones and Communities as a whole must operate in accordance with the Strategic Plan and benefit residents. Empowerment Zones and Enterprise Communities are required to report all activities related to their Strategic Plans.

OIG Evaluation of Auditee Comments

For the activities we reviewed from the June 1997 Performance Reviews, HUD did not detect that the four Zones inaccurately reported the actual status and progress for over 95 percent of the activities. The OIG understands the Empowerment Zone Program was established to rebuild communities in poverty-

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stricken inner cities and rural areas by developing and implementing strategic plans.

None of our findings are based on the premise that only Empowerment Zone funded activities should be reported as Zone activities. We questioned the reporting of activities as Empowerment Zone activities when the activity was not initiated or expanded as a result of the City's designation as a Zone. The commingling of Zone and other activities which were initiated prior to the start of the Empowerment Zone Program or were not expanded because of the Program overstates the actual impact of the Program. We acknowledge that the statute (42 USC Section 1397) and HUD's regulation (24 CFR Part 597) do not provide a specific definition for an Empowerment Zone activity.

We believe an activity should be initiated or expanded as a result of a City's Zone designation and benefit Zone residents before the activity is reported as an Empowerment Zone activity. This approach is an appropriate method to accurately measure the impact of the Empowerment Zone Program. Our approach does not overstate the impact of the Empowerment Zone Program, it only counts actions for which the Program is a catalyst and if the activity benefits Zone residents, which is a Program requirement. 42 USC Section 1397f(c)(1)(C) says "an area shall use the grant for activities that benefit residents of the area for which the grant is made". In order for HUD to accurately measure the impact of the Empowerment Zone Program, HUD must ensure that Zones accurately report the accomplishments of their Programs.

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### Auditee Comments

The EZ/EC Office strongly agrees with the premise that accurate reporting is a key to properly evaluating the results of the EZ/EC Initiative and is working to improve its system for verifying accuracy. The new EZ/EC Performance Measurement System is an Internet-based system that eases Empowerment Zone and Enterprise Community reporting and lowers its cost. Work on the System, which began prior to the OIG's audit, will allow for more accurate reporting by heightening the knowledge and awareness on the part of the Zones and Communities of reporting requirements, increasing technical proficiency, and easing access to relevant data. As part of the System, a consultant

is working with the Zones and Communities to improve reporting.

The EZ/EC Office constantly strives to improve its Performance Measurement System, including the reporting of results. To impress upon Empowerment Zones and Enterprise Communities the importance of this aspect of the Initiative, the Office promotes greater use of performance measurement systems as a tool to enhance efficiency in the allocation of scarce Empowerment Zone and Enterprise Community resources.

OIG Evaluation of  
Auditee Comments

The actions planned by HUD to implement a new reporting system should correct the problem, if HUD establishes procedures and controls to verify the accuracy of the information reported.

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Auditee Comments

The draft report overstates discrepancies in the amount of leveraged funding. This mistake also is largely attributable to the OIG's wrongheaded view of which activities are actually Empowerment Zone activities.

OIG Evaluation of  
Auditee Comments

Contrary to the Coordinator of the EZ/EC Initiative's comments, the majority of the overstatements of funding occurred at two Cities because of mathematical errors, not interpretations of what constitutes an Empowerment Zone activity. Our review disclosed that the Cities of Chicago and Detroit overstated their leveraged funds by over 535 percent and 18 percent, respectively. In addition, all four Zones overstated leveraged funds due to the inaccurate reporting of activities as Zone activities when they were not initiated or expanded as a result of the Cities' Zone designations. As previously noted, the commingling of Zone and other activities which were initiated prior to the start of the Empowerment Zone Program or were not expanded because of the Program distorts the actual impact of the Program.

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Auditee Comments

The EZ/EC Initiative had procedures and controls to verify the self-reporting by the Empowerment Zones and Enterprise Communities.

OIG Evaluation of  
Auditee Comments

HUD established policies regarding the verification of Performance Reviews; however, HUD did not have procedures

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and controls to ensure the policies were implemented and the Zones' reporting was accurate. HUD needs to develop procedures and controls that ensure reports are accurate.

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**Auditee Comments**

We agree with the OIG recommendation that HUD should establish procedures and controls to ensure that verification of Performance Reviews are conducted as required. Although such controls already were in place, the EZ/EC Office recognizes that improvements can be made. The EZ/EC Initiative Office is currently working with the Public Trust Officers to develop a methodology to verify the latest reports submitted by the Empowerment Zones and Enterprise Communities. The Public Trust Officers will choose a statistically valid sample of Zone and Community activities and verify the information submitted in the annual reports. The Officers also will check to see if governance structures are operating effectively.

**OIG Evaluation of Auditee Comments**

Our audit determined that HUD did not have procedures and controls to ensure the four Zones accurately reported the accomplishments of their Empowerment Zone Programs. The four Zones accurately reported less than five percent of the activities we reviewed from the June 1997 Performance Reviews. The actions planned by HUD to implement a new reporting system should correct the problem, if HUD establishes procedures and controls to verify the accuracy of information reported.

**Recommendation**

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

2A. Establishes procedures and controls to ensure that verifications of Performance Reviews are conducted as required.





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# Management Controls

In planning and performing our audit, we considered the management controls of HUD's Office of Community Planning and Development in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Management Controls

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

- Program Operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above.

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

## Significant Weaknesses

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

- Program Operations.

HUD did not ensure that the Empowerment Zones' activities complied with their Strategic Plans (see Finding 1).

- Validity and Reliability of Data.

HUD did not verify the accuracy of the Performance Reviews for the Empowerment Zone Program (see Finding 2).

- Compliance with Laws and Regulations.

HUD did not follow its regulations regarding the assessments of Empowerment Zones and the verification of Performance Reviews (see Findings 1 and 2).

- Safeguarding Resources.

HUD did not verify the appropriateness of the use of Empowerment Zone funds (see Finding 1).

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# Follow Up On Prior Audits

This is the first OIG audit focusing on HUD's oversight of the operations of the Empowerment Zone Program.

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# Empowerment Zones Reviewed

This appendix lists the activities we reviewed at the four Empowerment Zones we audited and a summary of our findings at each Zone. The four Zones were the Cities of Atlanta, Chicago, Detroit, and Philadelphia. We judgmentally selected a total of 64 activities reported in the June 30, 1997 Performance Reviews for the four Zones. We found that the Cities inappropriately used/committed or lacked documentation to support the use of Empowerment Zone funds, and inaccurately reported the accomplishments of their Programs to HUD for 61 of the 64 activities.

## City Of Atlanta's Empowerment Zone

The City of Atlanta did not have adequate control over its Empowerment Zone funds. Specifically, the City inappropriately: used Empowerment Zone funds to pay \$739,178 for services that did not benefit Zone residents and was billed another \$53,979 for services that also did not benefit Zone residents; used \$429,241 of Zone funds to assist in the relocation of a business to the Zone, but the relocation of the business resulted in decreased employment and the closing of the business in its original location which is not an appropriate use of Zone funds; committed \$400,000 of Zone funds to assist in the relocation of another business to the Zone which will result in the closing of the business and decreased employment in the original location; and provided \$8,000 of Zone funds to assist in the purchase of a home located outside of the Zone. The City also did not competitively bid a contract awarded under the Empowerment Zone Program, inaccurately reported the accomplishments of its Zone activities, and incorrectly reported nine activities as Zone activities when they were not.

We judgmentally selected 16 of the City of Atlanta's 123 activities reported in the June 30, 1997 Performance Review. The following table shows the 16 activities reviewed:

### Activity

<b>1. Atlanta Center for Home Ownership</b>
<b>2. Revolving Loan for Creative Fine Arts</b>
<b>3. Mortgage Assistance Program</b>
<b>4. Revolving Loan for Corporate Courier</b>
<b>5. Sweet Auburn Curb Market</b>
<b>6. Revolving Loan Fund</b>
<b>7. Pittman Park Improvements</b>
<b>8. Joyland Park Improvements</b>
<b>9. Chosewood Park Tennis Courts Improvements</b>
<b>10. Daniel Stanton Recreation Center</b>
<b>11. Sidewalk Repair</b>
<b>12. Bridge Repair</b>
<b>13. Storm Drainage Improvements</b>
<b>14. Reynoldstown Community Revitalization Project</b>
<b>15. Historic District Community Revitalization Project</b>
<b>16. Revolving Loan Fund - Miss Piggy's</b>

City Of Chicago's  
Empowerment Zone

The City of Chicago did not use its Empowerment Zone funds appropriately and did not correctly report the accomplishments of its Empowerment Zone Program to HUD. Specifically, the City: inappropriately used \$670,417 of Empowerment Zone funds and was billed \$121,590 that did not benefit Zone residents; did not have documentation to show that another \$892,484 of Zone funds paid and \$120,012 billed to the City benefited Zone residents or were reasonable and necessary expenses; inaccurately reported the accomplishments of its Empowerment Zone activities; and reported 15 projects as Empowerment Zone activities when they were not.

We judgmentally selected 26 of the City of Chicago's 84 activities reported in the June 30, 1997 Performance Review. The following table shows the 26 activities reviewed:

<i>Activity</i>
<b>1. Mexican Fine Arts Museum Expansion</b>
<b>2. Job Link Program</b>

<b>3. Family Life Community Network</b>
<b>4. 21<sup>st</sup> Century Community Learning Centers</b>
<b>5. Better Days for Youth and Nuevos Futuros</b>
<b>6. Employer Assisted Housing Program</b>
<b>7. Northwest Industrial Corridor</b>
<b>8. Community Services West Workforce and Life Preparation</b>
<b>9. The Storehouse Distributions Center</b>
<b>10. Arts Business Incubator</b>
<b>11. Chicago Neighborhood Plan Program</b>
<b>12. Self-Sufficiency Project</b>
<b>13. Holistic Connection</b>
<b>14. Youth Economic Alternatives</b>
<b>15. Linking to the Service Delivery Network</b>
<b>16. Brownfields Redevelopment Institute</b>
<b>17. Woodworker/Shipping Training</b>
<b>18. Expansion of Services for Connections Adult Learning Center</b>
<b>19. Fresh Start Program</b>
<b>20. Comprehensive Service Delivery Network</b>
<b>21. Street Intervention Program</b>
<b>22. Duncan YMCA Children's Arts &amp; Education</b>
<b>23. Vocational Education &amp; Community Development Program</b>
<b>24. Violence Prevention Program</b>
<b>25. Community Youth Development Activity Network</b>
<b>26. West Side Residential Rehabilitation</b>

City Of Detroit's  
Empowerment Zone

The City of Detroit did not correctly report the accomplishments of its Empowerment Zone Program to HUD. In one instance, the City used a small amount of Empowerment Zone funds that did not benefit Zone residents. Specifically, the City: inaccurately reported the accomplishments of its Empowerment Zone activities to HUD; overstated its leveraged funding by more than \$460 million; and incorrectly reported a program as an Empowerment Zone activity when it was not. The City also used Zone funds that did not benefit Zone residents. The amount of funds not properly used was small (\$2,879); however, the problem was easily identifiable and could cause more significant problems in the future if not corrected.

We judgmentally selected 10 of the City of Detroit's 73 activities reported in the June 30, 1997 Performance Review. The following table shows the 10 activities reviewed:

*Activity*

1. Mexican Welcome and Retail Center
2. Southwest Detroit Contaminated Site Redevelopment Demonstration Project
3. Neighborhood Partnership Academy
4. Recreation Facilities Enhancement Project
5. Arts Access
6. Hemoglobin Immune-deficiency Virus Prevention and Intervention Strategy
7. Mercy Education Project
8. Male and Female Responsibility Program
9. Community Self Sufficiency Centers
10. Industry Specific Training on Health Care

City Of Philadelphia's Empowerment Zone

The City of Philadelphia did not use its Empowerment Zone funds appropriately and did not correctly report the accomplishments of its Empowerment Zone Program to HUD. Specifically, the City: inappropriately used \$83,998 of Empowerment Zone funds that did not benefit Zone residents; did not have documentation to show that another \$32,934 of Zone funds paid and \$4,367 billed to the City benefited Zone residents or were reasonable and necessary expenses; spent \$30,280 of Zone funds above the amount approved; inaccurately reported the accomplishments of its Empowerment Zone activities; and reported one project as an Empowerment Zone activity when it was not.

We judgmentally selected 12 of the City of Philadelphia's 109 activities reported in the June 30, 1997 Performance Review. The following table shows the 12 activities reviewed:

<i>Activity</i>
<b>1. Lead Abatement Program</b>
<b>2. Safety/Security Program</b>
<b>3. Supervised Child Playsite</b>
<b>4. Multipurpose Athletic Field</b>



<b>5. Child Care Conference</b>
<b>6. Cecil B. Moore Commercial Corridor</b>
<b>7. Youth Landscape Training Program</b>
<b>8. Life Long Learning and Training Center</b>
<b>9. Mini-Mobile Police Stations</b>
<b>10. Community Lending Institution</b>
<b>11. Community Capital Institution</b>
<b>12. Revolving Capital Fund</b>

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# Auditee Comments

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D.C. 20410-7000

OFFICE OF THE ASSISTANT SECRETARY FOR  
COMMUNITY PLANNING AND DEVELOPMENT

March 12, 1999

MEMORANDUM FOR: Dale L. Chouteau, District Inspector General for Audits,  
Midwest

FROM: Dennis Kane, Coordinator, EZ/EC Initiative, DE

SUBJECT: Comments On Draft Audit Report Concerning The Empowerment  
Zone/Enterprise Community Initiative

Attached, please find comments related to your office's draft audit report entitled, "HUD's Oversight of the Empowerment Zone Program," which is based on audits of four Empowerment Zones (Atlanta, Chicago, Detroit & Philadelphia/Camden) and a review of HUD's EZ/EC Initiative Office which is housed within HUD's Office of Community Planning and Development.

This office strongly believes that the report draws a number of erroneous conclusions based on the fact that the OIG evaluated this office and the four EZs based on an incorrect interpretation of the statutes, regulations and policies that govern the EZ/EC Initiative. In addition, this office believes that the OIG used a questionable methodology in conducting this audit, as well as the audit of the four EZs, which raises serious questions about the validity of numerous conclusions drawn in the report.

This Office stands ready to work with the OIG to ensure that HUD's oversight of the EZ/EC Initiative is effective in light of applicable statutes and regulations.

Thank you for your time and consideration of these comments.

**COMMENTS ON DRAFT AUDIT REPORT CONCERNING THE**

## **EMPOWERMENT ZONE/ECONOMIC COMMUNITY INITIATIVE**

The Office of the Inspector General (“OIG”) did not properly evaluate the Empowerment Zone/Enterprise Community Initiative (the “EZ/EC Initiative” or the “Initiative”), primarily because it did not understand the nature of the Initiative and employed questionable scope and methodology in its audit. Many of the findings in the OIG’s draft audit report on the Initiative (the “Draft Report”) are based upon a fundamental misunderstanding of the design and purposes of the EZ/EC Initiative. The EZ/EC Initiative represents a new type of program. It is based on a strategic plan, designed to stimulate solutions to local challenges and is created by local stakeholders. One of the hallmarks of the Initiative is that each Empowerment Zone (“EZ” or “Zone”) and Enterprise Community (“EC”) takes a holistic view of the community to be served and the actions that may be taken to create new opportunities for residents, communities and businesses. The vision of each EZ and EC is encapsulated in a strategic plan that includes a set of performance benchmarks to track the progress of the EZ or EC. This is a new method for measuring the success of a federal program. A more traditional approach would simply measure the amount of dollars expended on the project. However, under the EZ/EC Initiative, results are measured against performance benchmarks set by the local community. Strategic plans provide the blueprints for EZ/EC actions as well as the Department’s evaluation of EZs and ECs.

The Initiative is designed to encourage and harness the collaborative efforts of 25 federal agencies, over 45 state governments, hundreds of local governments, thousands of businesses, numerous non-profits and faith-based groups, and millions of residents of distressed and underserved communities. HUD has a different role in managing the EZ/EC Initiative than it does in its traditional programs. As the lead federal agency for the Initiative, HUD is the primary federal contact with the EZ/ECs. In that role, HUD approved the strategic plans and projects and programs being implemented to achieve the plan, and provides technical assistance to help the local community achieve its vision.

HUD works with the IRS which is responsible for the tax incentives available to EZs and ECs. HUD also works in close collaboration with the U.S. Department of Health and Human Services (“HHS”), which is the grantor of the bulk of the federal funds allocated to the EZ and ECs. The HHS grants, known as EZ/EC SSBG awards, were authorized by the Congress in 1993 and they were awarded to the appropriate states. They are a special form of very flexible Social Services Block Grants. The states, in accordance with HHS and HUD guidance and regulations, establish sub-grantee relationships with local entities to provide the EZ/EC SSBG awards to localities for EZ and EC projects and programs designed to implement the local strategic plan. HUD, HHS, the states, cities and the EZs and ECs all have a role in helping to ensure that funds are spent in accordance with applicable laws and regulations.

One of HUD’s primary statutory roles is to monitor whether each EZ and EC is making progress in implementing its strategic plan. Within this structure, the Initiative is designed to minimize the effects of government regulation and give EZ/ECs flexibility in addressing the needs and priorities of their localities. Astoundingly, it appears that the OIG somehow failed to realize that HUD funds are not a major source of funding for the EZ/EC Initiative. Rather than welcoming this new model for government programs and evaluating it consistent with the intent

of the Initiative's designers, the OIG imposes its own policy preferences onto the EZ/EC Initiative. This is not the proper role for an OIG audit. In short, many of the Draft Report's findings do not make sense when viewed through the lens of the intended scope and purpose of the EZ/EC Initiative. Even though some of these points were made in response to the audits of the four EZs that served as the foundation for this Draft Report,<sup>1</sup> the OIG has persisted in its unduly narrow view of the Initiative. While the Department takes issue with many aspects of the Draft Report, it is this fundamental difference of opinion over the basic design and purposes of the Initiative that renders the majority of the findings in the Draft Report invalid.

The Draft Report also evidences a highly questionable scope and methodology of the review of the EZ/EC Initiative. There is simply no explanation of the basis for the OIG's selection of individual EZs and activities to audit. For example, the Draft Report contains no justification for the selection of the four Zones that were audited to the exclusion of the other 5 EZs and all 65 ECs. The Draft Report fails to offer any explanation of the statistical relevance of the 64 activities reviewed out of a total of more than 2,000 engaged in nationwide by the Initiative. The Draft Report also does not provide a satisfactory explanation for the selection of the particular 64 activities out of the 389 carried out by the 4 Zones audited by the OIG. Taken together, these issues raise fundamental questions concerning the design and fairness of the audit.

**In sum, we agree with the Philadelphia Inquirer which referred to the OIG's review as a "Drive-by Audit" and stated that the OIG's "look at Empowerment Zones lacks substance." The Inquirer went on to say that the OIG's findings "smacked of nitpicking, and its release, just before a second round of funding for "e-zones" was authorized, hinted of politics." Attachment 1, "Drive-by Audit: HUD Look at Empowerment Zones Lacks Substance," Philadelphia Inquirer, Oct. 20, 1998, at A18. The Inquirer aptly noted, "Three weeks ago the city noted three years of slow but steady progress, citing creation of 400 jobs, setting up a first-ever loan fund for small and minority-owned businesses, and even putting a baseball field in a formerly trash-strewn lot. Not a word of these solid if small achievements made it into the audit. No experiment is without flaws, and they should be pointed out. But the taxpayers deserved a more balanced picture than this." *Id.* Consequently, the OIG should retract the flawed Draft Report and initiate a new audit conducted in accordance with Generally Accepted Government Auditing Standards.**

#### The Draft Report Misconstrues the Nature of the EZ/EC Initiative

The Initiative creates a partnership between the federal government and the EZs and ECs. The federal government's primary role in this partnership is to provide the resources, expertise and support necessary to help the EZs and ECs implement their strategic plans and achieve their strategic visions. This federal role includes a Community Empowerment Board, an EZ/EC Initiative Office at HUD and USDA, and 25 federal agencies with varying levels of involvement with the Initiative. These entities provide high level commitment to coordinating the federal partnership with EZs and ECs. This commitment includes technical assistance, and help with

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<sup>1</sup> In addition to the responses to each audit given by the cities, news accounts expressed criticisms of OIG's findings and methods. See, e.g., Attachment 2, "Drive-by Audit: HUD Look at Empowerment Zones Lacks Substance," Philadelphia Inquirer, Oct. 20, 1998, at A18.

requests for program waivers, coordination of conferences and workshops, and publication of information to assist the EZs and ECs.

Congress authorized HHS to provide the bulk of federal assistance to the EZs and ECs through the Omnibus Budget Reconciliation Act of 1993. The authorizing statute requires that all projects funded in whole or in part with EZ/EC SSBG funds meet the following requirements:

- They must be directed at one or more of the following SSBG goals:
  1. achieving or maintaining economic self-support to prevent, reduce or eliminate dependency;
  2. achieving or maintaining self-sufficiency, including reduction or prevention of dependency; or
  3. preventing or remedying neglect, abuse, or exploitation of children and adults unable to protect their own interests, or preserving, rehabilitating, or reuniting families.
- They must be included in the EZ's or EC's current strategic plan; and
- They must attempt to produce some benefits for residents of the designated neighborhoods. 42 USC 2000.

The EZ/EC SSBG grants are provided “For the purposes of consolidating Federal assistance to States for social services into a single grant, increasing State flexibility in using social service grants, and encouraging each State” to address the challenges faced by the local EZ or EC. 42 U.S.C. § 1397. HUD ensures that funds are spent according to EZ and EC strategic plans and that projects and programs benefit residents. HHS and the states issue regulations regarding the eligible uses of EZ/EC SSBG funds. Individual states and cities share primary responsibility for ensuring the EZs and ECs spend funds according to the relevant laws and regulations. The recipients of the EZ/EC SSBG funds, the actual service providers, are responsible for spending the funds in accordance with applicable laws and regulations.

According to Federal statute, the states – not HUD – are responsible for auditing EZ and EC funds. See 42 U.S.C. § 1397e. In accordance with the structure of the Initiative, if HUD somehow identified an impropriety in the expenditure of EZ or EC funds, the Department would refer the problem to HHS, the state and the city responsible for the EZ or EC.) In addition, if there are questions about the eligible uses of EZ/EC SSBG funds, HUD refers those questions to HHS for clarification.

HUD's primary role in monitoring the expenditure of EZ and EC funds is quite different from the role of HHS, states, cities and the EZs and ECs. HUD ensures that the funds are spent according to an EZ's or EC's strategic plan and approves projects and programs prior to implementation to ensure they benefit residents. To fulfill this function, HUD – as well as the local governance boards and the states – reviews all projects and programs against the relevant strategic plan prior to approving their implementation, thereby ensuring that residents of the

designated area will benefit from the activities. Given the broad nature of EZ and EC strategic plans, a community has great flexibility in designing projects and programs that advance the strategic plan. This flexibility is one of the hallmarks of the program and is needed to retain and encourage local creativity and problem-solving.

HUD's response to irregularities is limited by statute and regulation. The circumstances whereby an EZ or EC designation may be revoked by HUD is limited to situations in which a state or locality unilaterally modifies EZ or EC boundaries or fails to comply with or make progress toward the benchmarks in the strategic plan. 26 U.S.C. § 1391(d)(2) (1998). Consistent with this statutory scheme, regulations require periodic reviews of EZs and ECs by HUD. 24 CFR §§ 597.402-597.403. Prior to revoking any designation, HUD must send a letter of warning requesting a reply within 90 days. 24 CFR § 597.403. Revocation of designation or a change in status from EZ to EC, or vice-versa, are the only sanctions permitted HUD by statute or regulation. Improper use of funds that falls outside these parameters must be dealt with by HHS – not HUD.

The EZ/EC Initiative has four key principles. These are:

- Economic Opportunity;
- Sustainable Community Development;
- Community-based Partnerships; and
- Strategic Vision for Change.

These principles must be recognized by any evaluator of the Initiative. Important to the draft audit is that each of these key principles dictates broad solutions that recognize the environment in which each EZ or EC exists. For example, economic opportunity for an EZ or EC and its residents does not obey the borders of the EZ or EC. Rather, the economic health of the surrounding communities has a profound affect on each EZ and EC and must be considered when implementing a strategic plan. Accordingly, strict quantified barriers to achieving these four principles are inappropriate and should not be introduced through the audit process.

The OIG, throughout the Draft Report, fails to recognize the nature and structure of the EZ/EC Initiative. As noted in detail below, the Draft Report faults HUD's EZ/EC Initiative Office (the "EZ/EC Office" or the "Office") for shortcomings that are not part of the Department's role in the Initiative. For example, the Draft Report claims that the Department did not have adequate controls to assess the EZs. This finding is based upon artificial and illegitimate standards for evaluating the appropriate use of EZ and EC resources set forth by the OIG. The Draft Report – like the draft reports of the four individual Zones reviewed – asserts that individual EZ activities were inappropriate unless 51% or more of the activities' beneficiaries were EZ residents. The OIG should note that the EZ/EC Initiative differs from the Community Development Block Grant program which, according to statute and regulation, applies the 51% rule.

The Draft Report also inappropriately assumes that legitimate activities must occur exclusively within the physical confines of the EZ, be funded with Initiative resources and asserts

that activities begun prior to EZ designation are not reportable as Zone activities. These standards demonstrate the OIG's improperly narrow view of the EZ/EC Initiative. Other than the requirement of advancing the strategic plan, the statute governing the Initiative simply requires that the program benefit EZ or EC residents. See 42 U.S.C. § 1397f(c)(1)(C) (1998). Neither the statute nor the relevant regulations impose a rigid, quantified standard to be applied to each individual activity.<sup>2</sup> The OIG applied these standards in exactly that way and, in so doing, contradicted the intent of the Initiative which is to encourage creative, holistic solutions guided by an overall strategic plan to address difficult, longstanding problems. The Initiative was designed to move away from precisely the type of piecemeal thinking employed by the OIG. The OIG's improper standards are fundamental flaws of the Draft Report. Because the majority of the Draft Report's findings are premised on this fundamental misunderstanding, these findings are not valid. Indeed, adoption of the OIG's premises would cut the heart out of the EZ/EC Initiative by eliminating many programs which are providing a substantial benefit to Zone residents.

### The Audits Employed Questionable Scope and Methodology

The OIG's method of selection of Empowerment Zones and individual activities is not adequately explained in the Draft Report. The OIG audited four EZs during the course of its review. Nowhere does the Draft Report address the basis for selecting the entities to be audited. Why weren't any ECs reviewed? The Draft Report does not explain this imbalance. Why these EZs rather than others? Once again, the Draft Report provides no answers. However, OIG staff told us that the four Zones were selected in part because of the negative press they had received. If true, the selection process raises serious concerns. Anecdotal evidence from negative press accounts does not form an appropriate basis for selecting the sites for a fair and balanced audit. The comments of OIG staff leave the impression that entities were selected in order to skew the audit with as many negative findings as possible.

In addition, the Draft Report does not adequately explain the selection of activities for review. The Draft Report states that these activities were "judgmentally selected." Draft Report at 3. Unfortunately, there is no indication of the factors that were included in OIG's "judgment." The Draft Report does not indicate whether the quantity of funds used by the activities, the programmatic importance of the activities, the history of the activities or other factors entered into this "judgment." The consistently applied, objective basis for selecting the activities to review should be included in the report. Without this explanation of the scope and methodology of the audits, the Department does not view the Draft Report as a fair or representative depiction of the EZ/EC Initiative.

If there is any basis for the selection of particular cities and activities, HUD should have the opportunity to comment on the factors employed. Because the Draft Report does not include any justification for selecting particular activities, HUD has not been given a fair opportunity to respond to the OIG audit. It should be noted that the OIG refused to include HUD's comments in the reports on the underlying audits of the four individual EZs. This unjustified refusal raises the possibility of bias against the Department on the part of the OIG.

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<sup>2</sup> Attachment 2, Memorandum from David F. Polatsek to Dennis Kane, "Empowerment Zones – OIG Draft Audit – Benefit to EZ Residents," dated March 8, 1999.



The Draft Report also fails to present the statistical significance of the 64 activities. It is not clear that these activities constitute a valid statistical sample based either on the number of activities or the amount of dollars spent. Overall, the EZ/EC Initiative has more than 2,000 activities using several hundred million dollars. Given the lack of information regarding the selection of activities, there is no way to determine whether the 64 activities reviewed are in any sense representative of the overall EZ/EC Initiative. In fact, it is likely that they are not representative.

In addition, the OIG fails to present the statistical relevance of the selected activities for the individual cities reviewed. The OIG reviewed 16 of 123 activities in Atlanta, 26 of 84 activities in Chicago, 10 of 73 activities in Detroit, and 12 of 109 activities in Philadelphia. The number of activities selected at each site does not correspond to the overall number of activities for the site nor is there any explanation for the divergent levels of review of each EZ. Why did the OIG review 30% of the Chicago Zone's activities, while looking at a mere 11% of the Philadelphia Zone's activities? What are the relative funding levels of the activities examined compared to activities that were not examined? The Draft Report does not include any statement or analysis of the basis for selecting the particular activities within each Zone – other than the OIG's "judgment" – nor does it state the relative funding levels of the activities reviewed and not reviewed within each EZ. The Draft Report also fails to explain anomalies such as the failure to review a single activity in Camden even though such activities make up approximately one-fifth of the 109 activities of the Philadelphia EZ. Without any explanation to the contrary, the Department must conclude that the activities reviewed by the OIG are neither statistically significant nor representative of the EZ/EC Initiative or any of the individual Zones reviewed by the OIG. Consistent with Generally Accepted Government Accounting Standards, the OIG must include a disclaimer in its report that the sample of activities reviewed is not sufficient to draw conclusions about the program as a whole.

### **Finding 1 is Based on Misinterpretations of the Initiative's Operations**

The first finding of the Draft Report is predicated on a number of misinterpretations of the EZ/EC Initiative's operations. It appears that the OIG incorrectly interpreted the Initiative's statutory and regulatory requirements.

First, the Draft Report incorrectly describes the type of actions that trigger a HUD evaluation of the progress of an EZ or EC. Second, the OIG misstates the activities that should be reported to HUD. Third, the OIG evaluated the appropriateness of EZ activities based on unfounded conditions that run afoul of the statutes and regulations governing the Initiative.

By using incorrect interpretations of the EZ/EC Initiative statute, regulations and policies to evaluate the EZ/EC Initiative, the OIG dramatically exaggerated the management shortcomings of the EZ/EC Office and within the four EZs. Accordingly, finding 1 of the Draft Report does not fairly and adequately reflect the performance of the four EZs audited by OIG or the EZ/EC Office.

### HUD Had Adequate Controls to Assess the EZs and Take Corrective Actions

HUD had adequate controls to assess the EZs consistent with its statutory and regulatory responsibilities. HUD has two main statutory and regulatory responsibilities related to the EZ/EC Initiative. First, HUD is responsible for designating new urban EZ/ECs. See 26 U.S.C. § 1391 (1998); 24 CFR §§ 597.300-597.302. Second, HUD is responsible for “regularly” assessing the progress of the urban EZ/ECs so it can make a periodic determination as to the continuing eligibility of the EZ or EC. 24 CFR §§ 597.401-597.402. The Draft Report incorrectly described HUD’s monitoring responsibility.

HUD’s monitoring responsibility derives primarily from section 1391(d)(2) of the Omnibus Budget Reconciliation Act of 1993, which provides for the revocation of an EZ’s or EC’s designation if the HUD Secretary determines, among other things, that a designated EZ or EC has failed to make progress in achieving the benchmarks set forth in the strategic plan. The implication of this responsibility is that HUD will collect and review information relating to the progress of the EZs and ECs toward achieving their strategic plans.

The Department has issued regulations to implement this requirement. See 24 CFR §§ 597.400-597.403. Pursuant to regulation, EZs and ECs must submit “periodic” reports to HUD detailing the actions they have taken to implement their strategic plans. HUD uses this information to evaluate the progress of EZs and ECs.

To keep abreast of EZ/EC activities, HUD requires each EZ and EC to submit performance reports that detail the progress made toward implementation of the strategic plan. To date, HUD has formally evaluated the progress of the EZs and ECs once and released the results of that determination in March 1997. As a result of the first biennial evaluation, five of the 72 EZs and ECs were issued warning letters requiring them to improve their performance or risk losing their designation. The second biennial performance evaluation is due to be released in the second quarter of 1999.

HUD uses a number of tools to keep track of interim progress at each EZ and EC. For example, the EZ/EC Office receives feedback based upon annual field office assessments of EZ/EC progress. In addition to annual reports from EZs and ECs and field office assessments, HUD receives information regarding EZ/EC progress from:

- the applicable HUD Secretary’s Representative who is responsible for helping the particular EZ or EC implement its strategic plan;
- monthly phone conferences with the EZs and ECs;
- residents or other stakeholders associated with the EZ or EC;
- HHS – the agency that funds the EZ/EC Initiative;
- the States that are responsible for distributing the funds to the EZs and ECs;
- the lead entity responsible for implementing the EZ/EC strategic plan; and
- news accounts relating to particular EZs and ECs.

As noted above, one of the unique aspects of the EZ/EC Initiative is its reliance on performance measurement to ensure that local implementation efforts are a success. The HUD EZ/EC Office works closely with the EZs and ECs to ensure that they fully understand the principles of performance measurement and the importance of accurate reporting. In fact, the EZ/EC Office currently is working to implement a new Performance Measurement System (“PERMS”) to improve the understanding of EZs and ECs and the accuracy of reporting. Through PERMS, EZs and ECs will receive additional training on and technical assistance with performance measurement. Such assistance will include hands-on instruction from a consultant who will review EZ and EC reporting for accuracy and appropriateness.

In addition, each EZ and EC keeps track of the projects and programs it uses to meet the goals of its strategic plan. Plus the individual projects and programs have implementation plans (formerly called benchmarks) that track results such as the number of jobs created, the number of loans provided to businesses, and the number of child care slots provided to residents. The implementation plans, which are approved by the local EZ or EC governance structure, provide a blueprint for action by and evaluation of the EZ/ECs. Together with state and local government oversight these efforts result in continuous tracking of EZ and EC progress.

The Draft Report’s mistaken evaluation in this area seemed to be predicated on a judgment that HUD should undertake formal evaluations of EZs and ECs on an annual basis. Implementing laws and regulations do not contain a requirement for an annual review. As noted, HUD monitors EZ and EC performance on a continuing basis after receiving relevant information from multiple sources. Performing a formal annual assessment of EZ and EC progress would dramatically increase the cost of Initiative compliance, place an undue burden on the EZ/EC Initiative Office and local EZs and ECs, and impair the collaborative operating structure that is central to the design of the Initiative. In short, the introduction of a more rigid annual assessment as set forth in the Draft Report is inappropriate and inconsistent with the design and purposes of the Initiative.

With that as context, it should be noted that the Draft Report erroneously states that HUD did not perform an assessment of the progress of the Philadelphia EZ. Draft Report at 6-7. In fact, the EZ/EC Office maintained an ongoing dialogue with the Philadelphia EZ and the Office of HUD’s Secretary’s Representative. Indeed, the Coordinator of the EZ/EC Initiative Office visited the Philadelphia EZ to discuss performance-related issues on several occasions. Based upon this dialogue and the Philadelphia Zone’s continuing efforts to improve its performance, the EZ/EC Office determined that punitive action – such as a letter of warning – would have been counterproductive. This type of decision more readily fits within the expertise of the EZ/EC Office than that of the OIG.

The Draft Report mistakenly asserts that HUD did not plan to assess the Zones’ June 1997 Performance Review and did not use the field office assessments of the Philadelphia EZ to initiate corrective actions. HUD appropriately used both sources of information. As noted, a performance evaluation is due to be released next quarter. The EZ/EC Office also took actions directed to individual Zones. For instance, the 1997 Performance Reviews, in conjunction with the field office assessments, were used to identify and address management troubles at the

Philadelphia EZ. Based on these findings, the EZ/EC Office asked the Philadelphia EZ to file a new Performance Review. Next, the Office contacted the HUD Secretary's Representative and the Office of the Mayor to enlist help in addressing the findings of the reviews and assessments. OIG's failure to include information regarding these actions – and similar actions in Atlanta and Detroit – in the Draft Report is deeply troubling. This information was presented to the OIG and relevant individuals were identified and available for interviews. However, these actions were wholly absent from the Draft Report. The reason for this oversight is unclear, but it creates doubt as to the reliability and fairness of the report.

The Draft Report's recommendation that a letter of warning be issued in this situation is ill-advised. The EZ/EC Initiative Office only should take such an action when warranted. In the situation reviewed by the OIG, the Philadelphia EZ was making slow but steady progress. If overused, letters of warning can diminish the flow of ideas between the EZs and HUD and detract from the collaborative spirit of the Initiative. The constructive actions taken by the EZ/EC Office are more consistent with the design and purposes of the Initiative, while the Draft Report's recommendation displays an outmoded mentality favoring punitive measures rather than constructive engagement.

The Draft Report also is skewed by incomplete representations of the factual record. In particular, the Draft Report seizes upon portions of field office assessments of the Atlanta, Detroit and Philadelphia EZs at the expense of a balanced presentation. The Draft Report does not identify those activities on which the Zones were making progress. For some EZs and ECs, simply establishing a governance structure for the first time represents important progress. The Draft Report fails to note that the field office assessments cited did not recommend giving these EZs letters of warning.

In summary, HUD assessed the progress of EZ/ECs consistent with its responsibilities and the design and purposes of the Initiative. The Draft Report simply did not account for these aspects of the Initiative.

#### The Draft Report Mistakenly Criticizes HUD for its Procedures Regarding the Appropriate Use of Zone Funds

The Draft Report's conclusion regarding HUD's fiscal oversight seems to be based upon both a misconception of HUD's statutory role and the unduly narrow interpretation of appropriate activities previously discussed. "HUD and USDA are the lead Federal agencies with programmatic oversight and management responsibility for the overall EZ/EC program, while HHS has primary fiscal responsibility for the EZ/EC SSBG grants." Attachment 3, Letter from Donald Sykes of March 27, 1995, at 3 (emphasis added).

In keeping with Congressional intent, HHS' management and oversight of the EZ/EC Social Services Block Grant awards are consistent with its management and oversight responsibilities under the overall block grant program. HHS has written:

The EZ/EC SSBG grants, like all federal grants awarded to State governments, are subject to the Single Audit Act. As such, State auditors will be required to include these expenditures in their annual examinations. The auditors will be guided by the flexible authorizing legislation, as well as the HUD and USDA regulations and the broad HHS block grant regulations. The Department does not foresee imposing any additional fiscal audit requirements on the States or the Zones and Communities.

State grantee agencies will technically be subject to possible recoupment actions by HHS in the event that a Zone or Community uses the EZ/EC SSBG funds to finance an activity not allowed by the authorizing statute. However, in writing their strategic plans, the localities considered the broad authority underlying this new type of grant and included in their plans outlines of activities to be financed with the grant funds; as authors and implementers of the strategic plans that guide this effort, localities can be held accountable by the State for appropriate use of funds.

**Fiscal reporting requirements for State grantee agencies are minimal. HHS has attempted to keep these types of requirements to a small number, in order to lessen the burden on States and the local entities. The localities have much work to do to revitalize their neighborhoods; this Department would like them to focus on the details of that important work.**

Attachment 3. Clearly, HHS and States – not HUD – have responsibility for oversight of EZ/EC SSBG funds and they have sound reasons for applying standards and reporting requirements that are more flexible and consistent with the Initiative's goals and objectives than the misguided standards and requirements applied by the OIG.

The Draft Report cites the individual EZs audited for using funds that “did not benefit Zone residents.” Draft Report at 8. These conclusions are based upon the application of overly restrictive standards. For example, the OIG's criticism of the Atlanta EZ centered on the Atlanta Center for Home ownership program (“ACH”). The OIG's conclusion that fewer than 51% of individuals that benefited from ACH were EZ residents did not recognize the profile of the people served. In fact, many of the non-EZ residents served by ACH expressed an interest in finding housing within the Zone and the non-EZ residents typically had the same low-income profile as Zone residents. See Audit Report 98-CH-259-1005, City of Atlanta Empowerment Zone Program, at 86, Sept. 28, 1998. The OIG also used an invalid calculation to determine the amount of funds spent on non-EZ residents. The OIG assumed that the percentage of EZ residents served was the percentage of total ACH funds appropriately expended. See *Id.* at 84-86. The OIG's mistaken calculation had the affect of holding the Atlanta EZ to a standard of

100% Zone residents served and completely ignored the role of start-up costs in ACH expenditures. See Id. at 84-86. Accordingly, the OIG's criticism of the Atlanta EZ is unreliable.

The Draft Report also incorrectly holds HUD accountable for the fiscal responsibilities of states. By statute and regulation, the States are responsible for fiscal management issues related to the EZ/EC SSBG awards. It was the intention of the Congress that the States serve as the fiscal intermediaries for the EZ/EC SSBG funds and that the funds were to be used flexibly to help localities achieve their strategic plans. The EZ/EC SSBG awards, like all federal grants to States, are subject to the Single Audit Act which requires State auditors to include a review of EZ/EC SSBG expenditures in their annual examinations. Attachment 3. Within its limited role, the Department will work to ensure that all entities involved in the Initiative understand and implement their monitoring functions.

It is misleading for the OIG to criticize HUD for not having controls and procedures to evaluate the appropriate use of EZ/EC SSBG funds because the statutes and regulations governing the funds make it clear that HUD is not responsible for auditing such funds. As described in this response, the EZ/EC Office has controls to ensure that EZ and EC funds are spent according to the recipients' strategic plans. These controls help to properly fulfill HUD's monitoring role without overstepping its responsibility as prescribed by law. The Draft Report does not recognize HUD's limited role in this area.

### **Response to Finding 1 Recommendations**

#### **The EZ/EC Office Disagrees with Recommendation 1A**

The EZ/EC Office has adequate controls to assess progress toward strategic plans. The Draft Report's finding and recommendation on this point is unfounded. The EZ/EC Office monitors such progress on an ongoing basis and performs formal assessments when appropriate.

#### **The EZ/EC Office Agrees with Recommendations 1B and 1F**

While the EZ/EC Office takes issue with the facts that substantiate the Draft Report's findings, recommendations 1B and 1F address areas that the EZ/EC Office regularly seeks to improve. In fact, the Office is in the process of implementing a new EZ/EC Performance Measurement System that will improve reporting by the EZs and ECs. The EZ/EC Office also is working with field offices to verify the results of the most recent annual reports submitted by the EZs and ECs. Further, the Office is creating manuals for the policies and procedures related to the EZ/EC Initiative as well as developing training for Community Builders, Public Trust Officers and designees to ensure they understand and properly implement the policies and procedures. Taken together, these measures will improve current procedures and controls and benefit the Initiative.

#### **The EZ/EC Office Disagrees with Recommendations 1C, 1D and 1E**

The Draft Report's recommendations for taking action against particular Zones (recommendations 1C, 1D and 1E) are based upon mistaken findings and are inappropriate. The EZ/EC Office currently ensures that the Atlanta, Detroit and Philadelphia Zones make progress toward their strategic plans. The use of warning letters and recovery of funds is not called for because the specific shortcomings cited in the Draft Report are the result of the OIG's incorrect standards for Zone activities. Plus, such punitive measures should be used more thoughtfully than the Draft Report seems to suggest.

### **Finding 2 is Based on Inaccuracies and a Misunderstanding of the Initiative**

The Draft Report's support for finding 2 is plagued by inaccuracies and a misunderstanding of the design and purposes of the Initiative. The Draft Report vastly overstates the level of inaccurate reporting by the four EZs. Here again, the OIG applied standards to the EZ's Performance Reviews that are both unfounded and misguided. The Draft Report maintains that activities scheduled prior to EZ or EC designation or funded by means other than EZ or EC funds should not be reported. These limitations are imposed over and above the OIG's mistaken standards for judging benefit to Zone residents and the permissible locations for activities. As previously stated, neither the statutes nor the regulations impose these limitations on EZs and ECs. Instead, each of the EZs and ECs as a whole must operate in accordance with the strategic plan and benefit residents. EZs and ECs are required to report all activities related to their strategic plans. Such reporting provides the EZ/EC Office with a full picture of EZ and EC progress and vision, free of artificial distinctions based upon factors such as funding source and the date of initiation of a project. When the proper standards are applied, very few of the activities cited by the OIG run afoul of the flexible mandates set out by the Congress.

It is likely that the questionable scope and methodology of the audit skewed the Draft Report's findings. Among these issues is the possibility that the individual EZs were selected because of potential operational challenges, the lack of justification for the selection of specific activities and the failure of the audit to reach a statistically valid sample of EZs, ECs or activities. Given these problems, it is improper for the Draft Report to use percentages relating to the number of inaccuracies it claimed to find regarding reporting of activities and funds. These percentages convey nothing more than anecdotal – not to mention inaccurate – data. Using percentages creates a serious misimpression of statistical relevance. In short, the OIG's findings cannot be said to be applicable to or representative of the entire EZ/EC Initiative and the OIG should remove the percentages cited in this section of the Draft Report and note this serious shortcoming to dispel any misinterpretation.

Nevertheless, the EZ/EC Office strongly agrees with the premise that accurate reporting is a key to properly evaluating the results of the EZ/EC Initiative and is working to improve its system for verifying accuracy. The new EZ/EC Performance Measurement System ("PERMS") is an Internet-based system that eases EZ and EC reporting and lowers its cost. Work on the PERMS, which began prior to the OIG's audit, will allow for more accurate reporting by heightening the knowledge and awareness on the part of EZs and ECs of reporting requirements, increasing technical proficiency, and easing access to relevant data. As part of the PERMS, a consultant is working with EZs and ECs to improve reporting.

The EZ/EC Office constantly strives to improve its performance measurement system, including the reporting of results. To impress upon EZs and ECs the importance of this aspect of the Initiative, the Office promotes greater use of performance measurement systems as a tool to enhanced efficiency in the allocation of scarce EZ and EC resources. For example, as part of the Round II EZ competition, the Office ensured that applicants incorporated performance measurements that were related to the implementation of the strategic plan.

The EZ/EC Office recognizes that the reporting systems in place can be improved. This includes the need to address any and all inaccuracies in performance reports. The PERMS should address these issues and improve the Initiative's overall reporting record.

#### The Draft Report Applied a Mistaken Definition of Zone Activity

As noted above, the OIG definition of Zone activity was too narrow. The result was a dramatic overstatement of inaccuracies by the Draft Report. In actuality, very few activities were incorrectly reported as Zone activities.<sup>3</sup> The Draft Report's assertion that 26 activities were incorrectly reported is wrong. HUD requires that EZs and ECs report all activities that help implement a communities' strategic plan. 24 CFR § 597.400. These activities can be funded with EZ/EC SSBG funds, other sources of funds, or in-kind contributions. As long as the EZ or EC is engaged in the activity to help implement its strategic plan the activity should be reported. This is the only way that the EZ/EC Office can fulfill its responsibility to ensure that progress is being made toward implementation of the strategic plan. The Draft Report's artificial tests relating to sources of funds, dates of initiation of an activity, location of an activity and percentage of beneficiaries living in the Zone are not supported by relevant law and should not have been applied in this audit.

Examples of activities that were properly reported – in spite of the Draft Report's assertions to the contrary – include a number of Atlanta projects. Prior to receiving EZ designation, Atlanta scheduled sidewalk repairs and storm drainage improvements. While the improvements might have occurred without EZ designation, Atlanta properly informed the EZ/EC Office of the status of the projects and the positive benefits derived by the Zone. The information gave the EZ/EC Office a fuller picture of progress toward achieving collaborative efforts for meeting the Atlanta EZ's remaining needs. The OIG's position would deprive the Initiative of these benefits.

#### The Draft Report Overstates Discrepancies in the Amount of Leveraged Funding

The Draft Report also overstates discrepancies in the amount of leveraged funding. This mistake also is largely attributable to the OIG's wrongheaded view of which activities are actually EZ activities. For example, the Draft Report asserted that Detroit overstated leveraged funds by \$8.9 million because the Industry Specific Training on Health Care program should not have been reported as a Zone activity. The OIG based this mistaken conclusion on the fact that the activity

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<sup>3</sup> Some activities also required additional documentation to establish proper reporting.



was scheduled prior to Detroit's designation as an EZ. See Audit Report 99-CH-259-1003, City of Detroit Empowerment Zone Program, at 11, Oct. 20, 1998. This assertion is without foundation. Detroit properly reported the activity as an EZ activity, and thus, did not overstate the amount of leverage that it reported to HUD.

The Atlanta sidewalk repair and storm drainage projects provide additional examples. The Draft Report maintains that the leveraged funds from the projects should not have been reported. Draft Report at 17. Once again, HUD is interested in a complete picture of EZ activity. Accordingly, these leveraged funds were properly reported by the Atlanta EZ.

#### HUD Had Procedures and Controls To Verify The Reviews

The EZ/EC Initiative had procedures and controls to verify the self-reporting by the EZs and ECs. The EZ/EC Office directed field offices to perform on-site verification of the accuracy of EZ/EC performance reviews. The Draft Report properly notes that these instructions were clear. Draft Report at 19. However, when the EZ/EC Office noticed reporting inaccuracies in the second annual EZ/EC report submitted in the late Summer of 1997, it immediately began to design a new performance measurement system that would improve EZ/EC reporting. Nationwide some results were verified, but improvements can be made. In addition, Public Trust Officers for the Office of Community Planning and Development ("PTOs") will review a statistically valid sample of EZ and EC activities to verify the results reported. This review may be expanded as necessary.

#### Response to Draft Report Recommendation 2

We agree with the OIG recommendation that HUD should establish procedures and controls to ensure that verification of Performance Reviews are conducted as required. Although such controls already were in place, the EZ/EC Office recognizes that improvements can be made. The EZ/EC Initiative Office is currently working with the PTOs to develop a methodology to verify the latest reports submitted by the EZs and ECs. The PTOs will choose a statistically valid sample of EZ and EC activities and verify the information submitted in the annual reports. The PTOs also will check to see if governance structures are operating effectively.

#### Conclusions on Management Controls Faulty

Due to the misunderstanding of the Initiative demonstrated in the Draft Report and the questionable scope and methodology of the audit, the EZ/EC Office does not agree with the conclusions regarding program operations, compliance with laws and regulations, and safeguarding resources set forth in the Draft Report. The EZ/EC Office agrees that verification of the accuracy of performance reviews should have been better, though the Draft Report's findings on this topic are inaccurate and exaggerated.

#### The EZ/EC Office's Program Operations Were Adequate

HUD ensures that EZ/EC activities complied with their strategic plans and there is a fully developed process to complete this check. First, each city and state signs a Memorandum of

Agreement (“MOA”) with HUD prior to the disbursement of EZ/EC SSBG funds. The MOA is accompanied by initial benchmarks agreed upon by all parties as compliant with the strategic plan. Second, the local governance board must give its approval. All EZ and EC implementation plans are approved by the local governance board prior to being submitted to the EZ/EC Initiative Office and the applicable State. Third, HUD checks to ensure that the Implementation plan was approved by the governance structure. Fourth, the state has a strong financial incentive to ensure that the implementation plan falls within the scope of the strategic plan because the State ultimately may be required to reimburse HHS if funds are inappropriately expended. This system comprises a prudent method for ensuring compliance with strategic plans. For the EZs reviewed, very few activities – not the multiple activities cited in the Draft Report – might not comply with the relevant strategic plan. While making no mistakes is the Initiative’s goal, falling short of perfection does not indicate a significant weakness in management controls. Plus, HUD will seek additional justification from some EZs to demonstrate that the activities in question benefited Zone residents.

#### Validity and Reliability of Data Can be Improved

As set forth above, the EZ/EC Office agrees that verification can be improved and is working to implement the necessary changes.

#### The EZ/EC Office Complied with Laws and Regulations

Many of the OIG’s interpretations of the relevant laws and regulations are simply incorrect. The EZ/EC Office assessed the EZs and verified performance reviews consistent with laws and regulations. Nothing in the statutes or regulations states that HUD must complete formal reviews on an annual basis. Because it is based upon an uninformed view of the laws and regulations, this conclusion should be removed from the report.

#### The EZ/EC Office Safeguarded Initiative Resources

The EZ/EC Office verified the appropriateness of the use of EZ and EC funds. Once again, the Draft Report used findings based upon unfounded interpretations of the law to reach this conclusion. The vast majority of the funds that the Draft Report questioned were used for legitimate activities. The funds are questioned because the OIG imposed erroneous limitations on EZ and EC activities. Such limitations should not form the basis of a finding regarding the Initiative’s management controls.

### **Reviews of the Four Zones Were Based on Misconceptions of the Design and Purposes of the Initiative**

The OIG failed to give HUD the opportunity to respond to the audits of the Atlanta, Chicago, Detroit and Philadelphia EZs. Without this unfortunate oversight, some of the

misconceptions demonstrated in this Draft Report might have been avoided. The four individual EZ audits were plagued by the same mistakes as noted in response to this audit. For example, the Atlanta EZ properly noted that the OIG was mistaken in assuming that activities funded by non-EZ funds should not be reported. Audit Report 98-CH-259-1005, City of Atlanta Empowerment Zone Program, at 74-75, Sept. 28, 1998. The Philadelphia EZ pointed out the OIG's numerous mistakes in concluding that funds for day care services did not benefit Zone residents. Audit Report 98-CH-259-1006, City of Philadelphia Empowerment Zone Program, at 106-108, Sept. 30, 1998. The Chicago EZ observed that the OIG's definition of "benefit" to Zone residents is too narrow and ignores many of the tangible and intangible benefits of EZ activities. Audit Report 99-CH-259-1002, City of Chicago Empowerment Zone Program, at 84, Oct. 15, 1998. Relevant excerpts from the Zones' responses to the individual audits are Attachment 4 to this response. Though the individual EZs correctly pointed out problems with the OIG audits, the EZ/EC Office is the more proper judge of, and expert on, the relevant issues of the design and purposes of the Initiative. Therefore, HUD's response should have been incorporated within each of the individual EZ audits.

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