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TO: Yolanda Chavez, Deputy Assistant Secretary for Grant Programs, DG

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FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: HUD Evaluated and Selected Applications for the Recovery Act's Neighborhood Stabilization Program 2 in Accordance With Applicable Requirements

HIGHLIGHTS

What We Audited and Why

We evaluated the U.S. Department of Housing and Urban Development's (HUD) award process for the Neighborhood Stabilization Program 2 (NSP2). Funding for NSP2 was provided through the American Recovery and Reinvestment Act of 2009 (Recovery Act). Under the Recovery Act, inspectors general are expected to be proactive and focus on prevention, thus we included a review of the NSP2 evaluation and selection process in our 2010 audit plan.

Our primary objective was to determine whether HUD's methodology and controls for the evaluation and selection of applications for the $1.93 billion in NSP2 funds were in accordance with applicable requirements. We added a second objective to determine whether HUD included special conditions in the grant agreements of high-risk grantees.

What We Found

HUD followed the applicable requirements during the evaluation and selection process and included special conditions in the grant agreements as required.

What We Recommend

There are no recommendations made in this report since no reportable deficiencies were identified.

Auditee's Response

We provided the draft report to the Deputy Assistant Secretary for Grant Programs on May 24, 2010, and discussed the report with the Director of the Office of Block Grant Assistance at an exit conference on June 8, 2010. The Director stated that HUD agreed with the report and would not be providing written comments.

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BACKGROUND AND OBJECTIVES

The Recovery and Reinvestment Act of 2009 (Recovery Act) provided $1.93 billion for a second Neighborhood Stabilization Program (NSP). NSP2 was to provide assistance for the redevelopment of abandoned and foreclosed-upon homes and residential properties so that such properties could be returned to productive use or made available for redevelopment purposes. Unlike the first NSP, which was formula based and provided only to State and local governments, Neighborhood Stabilization Program 2 (NSP2) funding was competition based and also available to nonprofit organizations. Applicants were required to apply by July 17, 2009, meet minimum threshold requirements for eligibility, and respond to six rating factors in the notice of funding availability (notice). The maximum number of points achievable was 150, and applicants had to score at least 115 to be considered for funding. The U.S. Department of Housing and Urban Development (HUD) considered NSP2 to be a component of the Community Development Block Grant program, and basic requirements of that program apply to NSP2.

Our primary objective was to determine whether HUD's methodology and controls for the evaluation and selection of applications for the $1.93 billion in NSP2 funds were in accordance with applicable requirements. We added a second objective to determine whether HUD included special conditions in the grant agreements of high-risk grantees.

RESULTS OF AUDIT

HUD Evaluated and Selected Applications in Accordance With Applicable Requirements

HUD's methodology and controls for evaluating and selecting the applications were in accordance with requirements in the notice. HUD received 482 applications from governmental and nonprofit entities for the NSP2 funds, with 469 making the July 17, 2009, deadline. HUD followed the required procedures for evaluating the 469 applications against threshold requirements, such as program eligibility, and then rated the 404 applications that passed threshold requirements against the six rating factors in the notice. At each step, HUD applied quality control procedures to ensure that its decisions were correct and supportable. HUD then ranked the 404 applications according to their scores and properly selected 56 for funding. Since other Office of the Inspector General (OIG) work[1] found that HUD failed to include special conditions in the grant agreements for high-risk recipients of the earlier formula-based NSP funds, we expanded our work to review the grant agreements for the 56 selected grantees and found that HUD included special conditions as required by the regulations.

HUD Evaluated and Selected Applications in Accordance With the Notice

Threshold Evaluation:
HUD evaluated the 469 applications making the July 17, 2009, deadline against the threshold requirements stated in the notice. At this phase, the applications needed to meet basic requirements such as program eligibility, requesting a minimum of $5 million, and submitting certifications. Several two-person teams reviewed the applications for the threshold requirements, and then a single four-person team performed a quality control review to verify that decisions to reject or accept applications were correct and supportable. As provided for in the notice, the quality control team contacted applicants with correctible technical deficiencies and allowed them 5 calendar days to correct a deficiency. Applications of applicants that did not respond were rejected. After evaluating for the threshold requirements, HUD rejected 67 applications.

We tested 34 of the 67 rejected applications to determine whether HUD properly evaluated them for the threshold requirements. We reviewed the threshold forms and the applications and found the same deficiencies that HUD noted for 33 of the 34 applications. The one application that was not correctly rejected was later identified by HUD during its final quality control review. HUD corrected the

[1]See Follow-up on Prior Audits.

error for this application plus another that was also incorrectly rejected and scored both applications according to the six rating factors.

Rating Factors Evaluation:
HUD properly evaluated and scored the 404 applications meeting threshold requirements against the six rating factors in the notice. First, each application was independently evaluated and scored by two persons. Then a panel comprised of these two persons plus two senior staff persons reviewed the two scoring forms as a group and completed a panel form with a consensus score. HUD performed a final quality control review of all applications to ensure that scores were supportable and to correct any discrepancies.

We tested 58 of the scored applications to determine whether HUD properly evaluated and scored them against the six rating factors. We reviewed the scoring and panel forms and found that information was generally verified, the scoring was consistent with guidance in the notice, partial and subjective scoring was supported, and the applications went through a final quality control review. As a result of this final quality control review, HUD found and corrected scoring mistakes on 8 of the 58 applications tested.

Selection:
HUD selected the applications for funding in accordance with the notice requirements. The notice required HUD to select applications based on the ranked order but allowed HUD to fund less than the full amount requested in an application to ensure a fair distribution of funds and to enable achievement of the purposes of NSP2. HUD staff ranked the 404 applications and recommended that the 36 with the highest scores be awarded the NSP2 funds. However, according to staff, the HUD Secretary wanted to fund additional applications. To fund additional applications with the available funds, staff applied a mathematical formula that redistributed funding and increased the number of funded applications to 56.

We tested HUD's methodology for selecting the 56 applications and awarding the funds. The application selection was carried out in accordance with the final rating and ranking. No application was skipped over to fund a lower rated application. At no time did HUD deviate from the ranking and rating system, and all applications were kept in the same order at all times. We also reviewed HUD's methodology for funding the applications. HUD consistently applied the mathematical formula to all fundable applications.

HUD Included Special Conditions for High-Risk Grantees

HUD included special conditions in the grant agreements for high-risk NSP2 grantees as required by the regulations. HUD included specific provisions in three grant agreements. Two were to ensure compliance with the 2010 Consolidated Appropriations Act concerning the Association of Community Organizations for Reform Now, and the other was to resolve a grantee's poor past performance.

We questioned whether HUD should have also included special conditions for grantees with outstanding OIG audit recommendations. HUD staff stated that special conditions for other high-risk applicants were incorporated through the competitive process. That process included requiring applicants to identify their experience, plans, approach, procedures, and controls in their applications so that HUD could review and evaluate them. Staff stated that this was the same corrective or remedial information that HUD required (24 CFR (Code of Federal Regulations) 570.910) in management plans for grantees with performance deficiencies.

We evaluated the applicable applications and related documents to determine whether special conditions were addressed and incorporated as the staff claimed. The grant agreements considered the application to be a part of the grant agreement.

We then reviewed applications for the nine applicants with open recommendations from previous OIG audits of Community Development Block Grants activities. We evaluated the management plans and applicable consortium agreements within the applications, plus other related documentation, to determine whether the procedures could prevent a recurrence of the problems identified in the audits.

Application rating factors 2 and 3 from the notice required the management plan to include budgets and schedules as well as monitoring and audit plans and responsibilities. If the application was for a consortium, it included an agreement specifying member responsibilities such as compliance monitoring. One applicant had a 100-plus-page monitoring plan to follow. Another applicant with 20 open audit recommendations had a later OIG audit that found that the applicant had the capacity to properly administer NSP funds. For all nine applicants, the procedures appeared adequate to prevent a recurrence of the deficiencies. Therefore, we agreed that HUD included special conditions for the high-risk applicants through the incorporation of the applications in the grant agreements.

Conclusion

HUD properly evaluated and selected the applications for the NSP2 funding. It followed the requirements and procedures in the notice and employed quality control procedures to help ensure that its decisions were correct and supportable. In addition, it properly included special conditions in grant agreements for high-risk grantees.

Recommendations

Our audit did not identify any reportable deficiencies, and, therefore, there are no recommendations.

SCOPE AND METHODOLOGY

To accomplish our objectives, we reviewed

- The notice and related HUD documents;
- 24 CFR 85.12 (special conditions for governmental units), 24 CFR 84.14 (special conditions for nonprofits), and 24 CFR 570.910 (corrective and remedial actions for Community Development Block Grants);
- The reliability of the three electronic forms (threshold, scoring, and panel) designed by HUD to document the application evaluation process;
- Applications and corresponding threshold, scoring, and panel forms;
- Grant agreements; and
- Applicable HUD OIG audit reports.

We also interviewed HUD's Community Development Block Grant staff.

We performed two attribute samples designed to test whether or not HUD correctly evaluated the applications. We statistically selected a sample from the 67 applications that HUD identified as failing the threshold requirements and a second sample from 403 applications that HUD evaluated against the six rating factors. HUD increased the number of applications evaluated against the six rating factors to 404 after we selected the sample. Both samples were based on a confidence level of 90 percent, a precision level of 10 percent, and an assumed error rate of 50 percent. We identified a statistical sample of 34 applications for the threshold testing and 58 applications for the six factors. Results of the sample testing showed that HUD correctly evaluated the applications. We used statistical sampling because each sampling unit was selected without preconceptions from the audit populations, thereby allowing these results to be projected to the populations.

We performed our onsite audit work from November 2009 through April 2010 at HUD's Office of Block Grant Assistance, 451 Seventh Street, SW, Washington, DC.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Controls over compliance with laws and regulations
- Controls over reliability of data

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we did not find any significant weaknesses.

FOLLOW-UP ON PRIOR AUDITS

The Office of Block Grant Assistance Lacked Adequate Controls Over the Inclusion of Special Conditions in Neighborhood Stabilization Program Grant Agreements, 2010-CH-0001, dated March 29, 2010

HUD OIG audited HUD's Office of Block Grant Assistance's (Office) controls over special conditions in NSP grant agreements under Title III of the Housing and Economic Recovery Act of 2008 (Act) as amended. The audit was part of the activities in our fiscal year 2010 annual audit plan. Our objective was to determine whether HUD's Office ensured that HUD's Office of Community Planning and Development field offices (field offices) were consistent in their consideration and inclusion of special conditions in NSP grant agreements with high-risk grantees.

HUD's field offices used different procedures for including special conditions in NSP grant agreements under the Act. Also, HUD did not ensure that the field offices were consistent in their consideration and inclusion of special conditions in NSP grant agreements with high-risk grantees.

We recommended that HUD's Deputy Assistant Secretary for Grant Programs require the Office to determine whether NSP grantees under the Act were high risk by considering grantees' past performance or other serious actions in their HOME Investment Partnerships (HOME), Emergency Shelter Grant, and/or Supportive Housing programs. If the NSP grantees were high risk, they should be required to develop and implement management plans for their programs that would include but not be limited to describing how unresolved HOME, Emergency Shelter Grant, and/or Supportive Housing program performance issues were resolved or were being resolved and explain whether the issues would impact the administration of their NSP. At the time of this report, the recommendation remained open.