



Issue Date	September 26, 2008
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Audit Report Number	2008-CH-1014
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TO: Jorgelle Lawson, Director of Community Planning and Development, 5ED

FROM:   
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: The City of Cincinnati, Ohio, Did Not Adequately Manage Its HOME Investment Partnerships Program

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the City of Cincinnati's (City) HOME Investment Partnerships Program (Program). The audit was part of the activities in our fiscal year 2007 annual audit plan. We selected the City based upon a request from the U.S. Department of Housing and Urban Development's (HUD) Columbus Office of Community Planning and Development and our analysis of risk factors relating to Program grantees in Region V's jurisdiction. Our audit objectives were to determine whether the City effectively administered its Program, appropriately provided match contributions (contributions) for its Program, and followed HUD's requirements. This is the third of three audit reports on the City's Program.

### **What We Found**

The City did not adequately manage its Program. It incorrectly reported Program contributions in its consolidated annual performance and evaluation reports (consolidated reports), lacked sufficient documentation to support Program contributions reported in its consolidated reports, inappropriately used Program and American Dream Downpayment Initiative (Initiative) funds, failed to ensure that it sufficiently protected Program funds, and lacked documentation to support

its use of Program and Initiative funds. These deficiencies have existed with the City's Program for at least three years.

The City did not comply with HUD's requirements in determining and reporting contributions for its Program. It incorrectly reported in its consolidated reports to HUD nearly \$2.6 million in Program contributions from 31 Cincinnati Habitat for Humanity (Habitat) projects that did not qualify as affordable housing and was unable to support more than \$1.8 million that it reported as Program contributions in its consolidated reports to HUD. In addition, the City inappropriately provided more than \$220,000 in Program funds for the 31 Habitat projects in which it did not sufficiently protect the Program funds.

We informed the director of the City's Department of Community Development and Planning (Department) and the Director of HUD's Columbus Office of Community Planning and Development of minor deficiencies through a memorandum, dated September 25, 2008.

### **What We Recommend**

We recommend that the Director of HUD's Columbus Office of Community Planning and Development require the City to implement a detailed comprehensive written action plan to improve its procedures and controls to ensure that the City operates its Program in accordance with HUD's and its own requirements, remove incorrectly reported Program contributions of nearly \$2.6 million from its consolidated reports to HUD, provide support for more than \$1.8 million or remove Program contributions from its consolidated reports to HUD and obtain Program contributions from nonfederal funds for housing that qualifies as affordable housing under the Program, reimburse its Program from nonfederal funds and decommit Program funds for the insufficiently protected Habitat projects, and implement adequate procedures and controls to address the finding 2 cited in this audit report.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided our discussion draft audit report and supporting schedule to the director of the City's Department, the City's mayor, and HUD's staff during the audit. We held an exit conference with the City's director on September 12, 2008.

We asked the City's director to provide comments on our discussion draft audit report by September 22, 2008. The director provided written comments, dated September 22, 2008. The director generally agreed with finding 1, but only partially agreed with finding 2. The complete text of the written comments, along with our evaluation of that response, can be found in appendix B of this report.

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## BACKGROUND AND OBJECTIVES

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**The Program.** Authorized under Title II of the Cranston-Gonzales National Affordable Housing Act, as amended, the HOME Investment Partnerships Program (Program) is funded for the purpose of increasing the supply of affordable standard rental housing; improving substandard housing for existing homeowners; assisting new homebuyers through acquisition, construction, and rehabilitation of housing; and providing tenant-based rental assistance. The American Dream Downpayment Assistance Act established a separate funding formula for the American Dream Downpayment Initiative (Initiative) under the Program to provide downpayment assistance, closing costs, and rehabilitation assistance to eligible first-time homebuyers.

**The City.** Organized under the laws of the state of Ohio, the City of Cincinnati (City) is governed by a mayor and a nine-member council, elected to two-year terms. The City's Department of Community Development and Planning (Department) administers the City's Program. The Department's overall mission is to serve as an innovative, proactive partner in supporting comprehensive economic and workforce development, quality housing development, historic conservation, land use management, arts and cultural amenities, and social services for all of the City's citizens. The City's Program records are located at 805 Central Avenue, Cincinnati, Ohio.

The following table shows the amount of Program and Initiative funds the U.S. Department of Housing and Urban Development (HUD) awarded the City for Program years 2003 through 2008.

<b>Program year</b>	<b>Program funds</b>	<b>Initiative funds</b>
<b>2003</b>	\$4,434,528	\$228,566
<b>2004</b>	4,428,285	269,714
<b>2005</b>	4,219,448	153,797
<b>2006</b>	3,977,487	76,743
<b>2007</b>	3,942,313	76,743
<b>2008</b>	<u>3,806,660</u>	<u>31,007</u>
<b>Totals</b>	<u>\$24,808,721</u>	<u>\$836,570</u>

The City awarded Program funds to Cincinnati Habitat for Humanity (Habitat), a nonprofit Christian housing ministry that seeks to eliminate substandard housing by building decent, affordable homes for low-income households in need, to provide utility tap and permit fee assistance for Habitat projects during Program years 2004 through 2007. Habitat sells the homes to the households at cost through non-interest-bearing loans. Habitat was the applicant for Program assistance and the owner of and mortgage holder for each project.

**HUD's monitoring review.** HUD assessed the City's Program through a May 2005 monitoring review. The monitoring review covered the City's compliance with regulations, statutes, and reporting requirements; monitoring of Program rental rehabilitation projects (rental projects) and owner-occupied single-family rehabilitation projects (owner-occupied projects); income

determinations; Initiative activities, and Program match contributions (contributions). HUD identified five findings and two concerns. As of August 2008, HUD had not performed monitoring reviews of the City's Program since its May 2005 review.

Effective June 2007, the City executed an agreement with HUD and the U.S. Department of Justice to settle all outstanding issues regarding the City's improper use of Program funds for the Huntington Meadows apartment project. The settlement agreement requires the City to reimburse its Program \$3.95 million. The final payment under the agreement is due by January 31, 2009.

Our audit objectives were to determine whether the City effectively administered its Program, appropriately provided contributions for its Program, and followed HUD's requirements. This is the third of three audit reports on the City's Program.

## RESULTS OF AUDIT

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### Finding 1: The City Did Not Operate Its Program in Accordance with HUD's and Its Own Requirements

The City did not adequately manage its Program. It incorrectly reported Program contributions in its consolidated annual performance and evaluation reports (consolidated reports) to HUD, lacked sufficient documentation to support Program contributions it reported in its consolidated reports to HUD, inappropriately used Program and Initiative funds, failed to ensure that it sufficiently protected Program funds, and lacked documentation to support its use of Program and Initiative funds because the City's management did not implement adequate procedures and controls to ensure that its Program was operated according to HUD's and its own requirements. These deficiencies had existed with the City's Program for at least three years. As a result, HUD and the City lacked assurance that Program funds were used efficiently and effectively and for eligible activities.

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#### Controls over Program Contributions Were Inadequate

The City did not comply with HUD's requirements in determining and reporting contributions for its Program. It incorrectly reported Program contributions in its consolidated reports to HUD, lacked sufficient documentation to support Program contributions reported in its consolidated reports to HUD, and failed to ensure that it sufficiently protected Program funds because it lacked adequate procedures and controls to ensure that HUD's requirements were appropriately followed. As a result, it inappropriately reported in its consolidated reports to HUD nearly \$2.6 million in Program contributions from 31 Habitat projects that did not qualify as affordable housing and was unable to support more than \$1.8 million that it reported as Program contributions in its consolidated reports to HUD. In addition, the City inappropriately provided more than \$220,000 in Program funds for the 31 Habitat projects in which it did not sufficiently protect the Program funds (see finding 2 of this audit report).

HUD's May 2005 on-site monitoring review determined that the City could not provide adequate supporting documentation for its Program contributions. In addition, the City did not use a Program contributions log.

### **The City Needs to Improve Its Controls over Reporting in HUD's System**

The City did not comply with HUD's requirements in its reporting of Program activity (activity) data in HUD's Integrated Disbursement and Information System (System). It inappropriately drew down, decommitted, obligated, and disbursed Program funds because it lacked adequate procedures and controls to ensure that HUD's requirements were followed. As a result, it did not decommit more than \$114,000 in Program funds accurately and in a timely manner and obligated more than \$816,000 and drew down and disbursed nearly \$442,000 in Program funds for an activity without entering into a written agreement or contract with the owner or developer of the property or having a current specified plan for how the property would be used to provide affordable housing to low- and moderate-income individuals. In addition, the City could not provide documentation to show whether activities with remaining balances of Program funds were active or that the City had recently reviewed the status of the activities (see finding 1 in Office of Inspector General (OIG) Audit Report # 2008-CH-1010, issued June 11, 2008).

HUD's May 2005 monitoring review determined that the City did not report activity data in HUD's System in a timely manner. Further, the City had open activities from 1994 through 2000 with remaining balances totaling more than \$400,000 in Program funds. HUD recommended that the City review its activities and expend funds for appropriate activities in a timely manner and/or close out or cancel activities and decommit and reprogram the remaining Program funds.

### **Controls over the City's Program Rental and Owner-Occupied Projects and Initiative Activities Were Inadequate**

The City did not comply with HUD's regulations and its rental rehabilitation program manual (manual) in providing housing rehabilitation assistance for rental projects. It provided assistance for rental projects with improper units, lacked documentation to support that units were eligible, and failed to ensure that it sufficiently protected Program funds because it lacked adequate procedures and controls to ensure that HUD's regulations and its manual were appropriately followed. As a result, it provided more than \$397,000 in Program funds to assist 11 units in three projects that did not qualify as affordable housing, was unable to support its use of more than \$590,000 in Program funds, and did not ensure that it sufficiently protected more than \$561,000 in Program funds used for housing rehabilitation assistance (see finding 2 in OIG Audit Report # 2008-CH-1010).



The City did not comply with HUD's regulations in providing housing rehabilitation assistance for owner-occupied projects. It provided assistance for improper owner-occupied projects and lacked documentation to support that owner-occupied projects were eligible because it lacked adequate procedures and controls to ensure that HUD's regulations were appropriately followed. As a result, it inappropriately provided more than \$225,000 in Program funds to assist three owner-occupied projects that did not qualify as affordable housing or in which the household was not income eligible and was unable to support its use of more than \$1.1 million in Program funds (see finding 1 in OIG Audit Report # 2007-CH-1017, issued September 30, 2007).

The City did not comply with HUD's regulations in providing downpayments, closing costs, homebuyer counseling, and home inspections for Initiative activities. It provided assistance for inappropriate Initiative activities and did not have documentation to support that activities were eligible because it lacked adequate procedures and controls to ensure that HUD's regulations were appropriately followed. As a result, it inappropriately provided \$41,000 in Initiative funds to assist five Initiative activities in which the households were not income eligible and was unable to support its use of more than \$266,000 in Initiative funds (see finding 2 in OIG Audit Report # 2007-CH-1017).

HUD's May 2005 monitoring review determined that the City was not consistent as to which definition of "annual income" it used to determine whether assisted households were income eligible. The City also did not consider appropriate inclusions and exclusions of income. In addition, it did not project household income in accordance with HUD's regulations.

## **Conclusion**

The previously mentioned deficiencies occurred because the City lacked adequate procedures and controls to ensure that it properly managed the day-to-day operations of its Program and appropriately followed HUD's and its own requirements. The City did not ensure that it fully implemented HUD's and its own requirements. The deficiencies in the City's Program are significant and demonstrate a lack of effective Program management. These deficiencies had existed with the City's Program for at least three years. As a result, HUD and the City lacked assurance that Program funds were used efficiently and effectively and for eligible activities.

## **Recommendation**

We recommend that the Director of HUD's Columbus Office of Community Planning and Development require the City to

- 1A. Implement a detailed comprehensive written action plan (plan) to improve its procedures and controls to ensure that the City operates its Program in accordance with HUD's and its own requirements. The plan should include the submission of quarterly reports to HUD's Columbus Office of Community Planning and Development detailing the City's progress in improving its procedures and controls regarding its Program in accordance with its plan. The quarterly reports should address but not be limited to the issues cited in this finding. If the City is unable to implement the plan, HUD should take appropriate action.

## Finding 2: Controls over the City’s Program Contributions Were Inadequate

The City did not comply with HUD’s requirements (see appendix C of this report) in determining and reporting contributions for its Program. It incorrectly reported Program contributions in its consolidated reports to HUD, lacked sufficient documentation to support Program contributions reported in its consolidated reports to HUD, and failed to ensure that it sufficiently protected Program funds because it lacked adequate procedures and controls to ensure that HUD’s requirements were appropriately followed. As a result, it inappropriately reported in its consolidated reports to HUD nearly \$2.6 million in Program contributions from 31 Habitat projects that did not qualify as affordable housing and was unable to support more than \$1.8 million that it reported as Program contributions in its consolidated reports to HUD. In addition, the City inappropriately provided more than \$220,000 in Program funds for the 31 Habitat projects in which it did not sufficiently protect the Program funds.

### The City Lacked Controls over Program Contributions

The City did not comply with HUD’s requirements in providing contributions for its Program. It drew down more than \$25.8 million in Program funds from its HOME investment trust fund treasury account (treasury account) for Program years 2002 through 2007. It was required to provide contributions for at least 12.5 percent of the Program funds it drew down from its treasury account during the period. Therefore, it was required to provide more than \$3.2 million in contributions for its Program for the period. The City reported in its consolidated reports to HUD nearly \$4.5 million in contributions for its Program during the period, for an excess in contributions totaling more than \$1.2 million. The following table shows the amounts of Program contributions the City was required to provide, Program contributions that the City reported in its consolidated reports to HUD, and excessive contributions for Program years 2002 through 2007.

Program year	Program contributions		
	Required	Reported	Excessive
2002	\$708,282	\$1,061,402	\$353,120
2003	508,538	408,475	(100,063)
2004	493,274	823,953	330,679
2005	583,816	463,050	(120,766)
2006	495,700	708,962	213,262
2007	439,965	984,196	544,231
<b>Totals</b>	<b>\$3,229,575</b>	<b>\$4,450,038</b>	<b>\$1,220,463</b>

\*Note that the City actually reported \$1,081,402 in Program contributions for Program year 2002. However, due to a calculation error, the City only counted \$353,120 as excessive Program contributions for the Program year. Therefore, we limited the amount of Program contributions reported for Program year 2002 to \$1,061,402.

In addition, the City had more than \$1.3 million in excessive Program contributions carried over from Program year 2001. Therefore, the City's excessive Program contributions at the end of Program year 2007 totaled more than \$2.6 million. The City failed to ensure that it determined and reported its Program contributions in accordance with HUD's requirements. Of the nearly \$4.5 million in contributions that the City reported in its consolidated reports to HUD for Program years 2002 through 2007, only slightly more than \$69,000 in contributions was eligible for its Program. The following table shows the amounts of Program contributions that the City reported in its consolidated reports to HUD and the amounts of Program contributions that were eligible, ineligible, and unsupported for Program years 2002 through 2007.

<i>Program year</i>	<i>Reported</i>	<i>Program contributions</i>		
		<i>Eligible</i>	<i>Ineligible</i>	<i>Unsupported</i>
2002	\$1,061,402	\$11,275		\$1,050,127
2003	408,475			408,475
2004	823,953	<u>57,821</u>	\$402,632	<u>363,500</u>
2005	463,050		463,050	
2006	708,962		708,962	
2007	<u>984,196</u>		<u>984,196</u>	
<b>Totals</b>	<b><u>\$4,450,038</u></b>	<b><u>\$69,096</u></b>	<b><u>\$2,558,840</u></b>	<b><u>\$1,822,102</u></b>

\*Note that we only included \$1,050,127 as unsupported contributions due to the City not including \$20,000 in reported Program contributions as excessive Program contributions for Program year 2002.

**The City Incorrectly Reported Nearly \$2.6 Million in Program Contributions from Habitat Projects**

The City inappropriately reported in its consolidated reports to HUD more than \$2.5 million in Program contributions from 31 Habitat projects during Program years 2004 through 2007. The contributions included cash donations, gifts-in-kind, volunteer labor, and/or sweat equity. Contrary to HUD's requirements, the City did not ensure that it implemented sufficient resale or recapture requirements in its restrictive covenants with Habitat or its consolidated plans. Therefore, it could not ensure that the projects would continue to qualify as affordable housing during the projects' affordability periods, and the nearly \$2.6 million from the Habitat projects was not eligible for the City to use to meet its Program contribution requirements.

**The City Lacked Sufficient Documentation to Support More Than \$1.8 Million in Program Contributions**

The City could not provide sufficient documentation to support an additional \$1.8 million that it reported as Program contributions in its consolidated reports to HUD during Program years 2002 through 2004. The City reported nearly \$1.1 million in Program contributions for project number 02.01.NON in Program year 2002. However, it could only provide sufficient documentation to support \$11,275 in City capital funds used for the project. It was unable to provide sufficient documentation to support more than \$1 million in Program contributions. For \$982,364 (reduced by the \$20,000 previously mentioned) in present discounted value of the yield forgone on taxes, it could not provide documentation supporting the value of the property and that the taxes were actually foregone. The City based the remaining \$67,763 on budget estimates rather than the actual amount of City capital funds used for the project.

The City reported more than \$400,000 in Program contributions for project number 03.01.NON in Program year 2003. However, it was unable to provide sufficient documentation to support the \$408,475 in Program contributions. The City based \$172,597 on budget estimates rather than the actual amount of City capital funds used for the project. It also could not provide source documentation for the remaining \$235,878 (\$408,475 minus \$172,597) in Program contributions.

The City reported more than \$400,000 in Program contributions for the North Fairmount Community Center project in Program year 2004. However, it could only provide sufficient documentation to support \$57,821 in donated property. It was unable to provide sufficient documentation to support \$363,500 in Program contributions for the project. For \$333,500 in donated soil, the City could not provide documentation supporting the value of the soil. The remaining \$30,000 was based on yield forgone from easement improvements, for which it could not provide documentation to support the value of the improvements.

**The City Did Not Sufficiently Protect More Than \$220,000 in Program Funds Used for the Habitat Projects**

The City provided \$220,026 in Program funds from January 2004 through August 2008 for the 31 Habitat projects. As previously mentioned, the City did not ensure that it implemented sufficient resale or recapture requirements in its restrictive covenants with Habitat or its consolidated plans. As a result, it could not ensure that the projects would continue to qualify as affordable housing

during the projects' affordability periods. Six of the projects had remaining balances in HUD's System totaling \$12,146 in Program funds.

### **The City Lacked Adequate Procedures and Controls**

The weaknesses regarding the City's contributions for its Program from and using Program funds for the improper Habitat projects and its lack of sufficient documentation to support Program contributions reported in its consolidated reports to HUD occurred because the City lacked adequate procedures and controls to ensure that it appropriately followed HUD's requirements. It did not ensure that it fully implemented HUD's requirements.

The housing division manager stated that the City's Department worked with the City's Law Department to develop the language in the City's restrictive covenants for the Habitat projects and that both Departments believed that the language in the restrictive covenants was sufficient to meet HUD's requirements.

### **Conclusion**

The City did not comply with HUD's requirements in determining and reporting contributions for its Program. As previously mentioned, the City inappropriately reported in its consolidated reports to HUD nearly \$2.6 million in Program contributions from 31 Habitat projects that did not qualify as affordable housing and was unable to support more than \$1.8 million that it reported as Program contributions in its consolidated reports to HUD. In addition, the City provided more than \$220,000 in Program funds for the 31 Habitat projects.

### **Recommendations**

We recommend that the Director of HUD's Columbus Office of Community Planning and Development require the City to

- 2A. Remove the \$2,558,840 in Program contributions from its consolidated reports to HUD for the contributions that it incorrectly reported in its consolidated reports to HUD for Program years 2004 through 2007.
- 2B. Provide supporting documentation or remove \$43,240 in Program contributions (\$2,602,080 in excess contributions less \$2,558,840 for incorrectly reported contributions) from its consolidated reports to HUD for the more than \$40,000 in excess contributions for which the City could not provide sufficient supporting documentation.

- 2C. Provide supporting documentation or remove \$1,778,862 in Program contributions (\$1,822,102 in unsupported contributions less \$43,240 in unsupported excess contributions) from its consolidated reports to HUD for the nearly \$1.8 million in required contributions in which the City could not provide sufficient supporting documentation. If the City cannot provide sufficient supporting documentation, it should obtain \$1,778,862 in Program contributions from nonfederal funds for housing that qualifies as affordable housing under the Program.
- 2D. Reimburse its Program from nonfederal funds for the \$220,026 in Program funds used during Program years 2004 through 2007 for the 31 Habitat projects in which the City did not sufficiently protect the Program funds.
- 2E. Decommit the Program funds inappropriately committed to the six Habitat projects, which have remaining balances in HUD's System totaling \$12,146.
- 2F. Implement adequate procedures and controls to ensure that the City obtains sufficient Program contributions from nonfederal funds for housing that qualifies as affordable housing under the Program.
- 2G. Implement adequate procedures and controls to ensure that housing assistance is provided in accordance with HUD's requirements.

## SCOPE AND METHODOLOGY

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To accomplish our objectives, we reviewed

- Applicable laws; HUD’s regulations at 24 CFR [*Code of Federal Regulations*] Part 92; HUD’s Office of Community Planning and Development Notice 97-03; Office of Management and Budget Circulars A-87 and A-122; HUD’s “Building HOME: A Program Primer”; Title 42, section 12750, of the *United States Code*; and Ohio Revised Code.
- The City’s accounting records; annual audited financial statements for 2005 and 2006; most recent internal audit report, dated October 2004; data from HUD’s System; Program and project files; computerized databases; by-laws; policies and procedures; organizational chart; consolidated annual plans; and consolidated reports.
- The Habitat’s accounting records, annual audited financial statements for 2006 and 2007, project files, and policies and procedures.
- HUD’s files for the City.

We also interviewed the City’s employees, Habitat’s employees, and HUD staff.

### **Finding 2**

We reviewed all of the nearly \$4.5 million in Program contributions that the City reported in its consolidated reports to HUD for Program years 2002 through 2007. The Program contributions were selected to determine whether the City effectively administered its Program, appropriately provided contributions for its Program, and followed HUD’s requirements.

We performed our on-site audit work from April through August 2008 at the City’s office located at 805 Central Avenue, Cincinnati, Ohio. The audit covered the period January 2006 through March 2008 and was expanded as determined necessary.

We performed our audit in accordance with generally accepted government auditing standards.



# INTERNAL CONTROLS

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

- Effectiveness and efficiency of operations,
- Reliability of financial reporting,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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

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## Relevant Internal Controls

We determined the following internal 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 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 Weakness**

Based on our review, we believe the following item is a significant weakness:

- The City lacked adequate procedures and controls to ensure that it complied with HUD's and/or its own requirements in regard to managing the day-to-day operations of its Program, providing contributions for its Program from and using Program funds for eligible Habitat projects, and maintaining sufficient documentation to support Program contributions reported in its consolidated reports to HUD (see findings 1 and 2).

### **Separate Communication of Minor Deficiencies**

We informed the director of the City's Department and the Director of HUD's Columbus Office of Community Planning and Development of minor deficiencies through a memorandum, dated September 25, 2008.

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
2A	\$2,558,840		
2B		\$43,240	
2C		<u>1,778,862</u>	
2D	<u>220,026</u>		
2E			<u>\$12,146</u>
Totals	<u>\$2,778,866</u>	<u>\$1,822,102</u>	<u>\$12,146</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In these instances, if the City implements our recommendation, it will cease using Program funds for improper projects.


# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

# City of Cincinnati



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Department of Community Development

September 22, 2008

Two Centennial Plaza  
Suite 700  
805 Central Avenue  
Cincinnati, Ohio 45202  
Phone (513) 352-6146  
Fax (513) 352-6113

Mr. Brent Bowen, Assistant Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
77 West Jackson Boulevard, Suite 2646  
Chicago, Illinois 60604-3507

Michael L. Cervay  
*Director*

Dear Mr. Bowen:

This letter serves as the City of Cincinnati's response to your letter dated September 8, 2008 related to the revised Phase 3 Discussion Draft Audit Report of HUD's Office of Inspector General for Audit. As with the past two (2) phases of the audit, the City of Cincinnati is committed to effectively administer federal programs in compliance with HUD and all federal agency guidelines. We appreciate the opportunity to resolve outstanding issues related to HUD HOME programs operating in Cincinnati.

We will address each finding, specific issue and recommendation in the order in which they were presented in your letter. HUD information is in italics. The City response follows the recommendation.

**Finding 1 – Recommendation 1A:**  
*We recommend that the Director of HUD's Columbus Office of Community Planning and Development require the City to implement a detailed comprehensive written action plan (plan) to improve its procedures and controls to ensure that the City operates its Program in accordance with HUD's and its own requirements. The plan should include the submission of quarterly reports to HUD's Columbus Office of Community Planning and Development detailing the City's progress in improving its procedures and controls regarding its Program in accordance with its plan. The quarterly reports should address but not be limited to the issues cited in this finding. If the City is unable to implement the plan, HUD should take appropriate action.*

**City Response to Recommendation 1A:**  
Many of the issues cited in the Phase 3 Audit Report that support Recommendation 1A above have already been discussed in detail in Phase 1 and 2 Audits. This includes reporting of Program activity in IDIS accurately and in a timely manner, rental rehabilitation and homeowner rehabilitation program compliance with HUD's regulations, and compliance issues related to the American Dream Down Payment Initiative Program (ADDI).

Equal Opportunity Employer

City of Cincinnati Response to Letter  
Dated 9/8/2008 from HUD's Office of Inspector General  
Re: Phase 3 Discussion Draft Audit Report

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**Comment 1**

The City has demonstrated its commitment to resolving all outstanding issues with HUD's Columbus Office of Community Development and Planning. The City has also documented measures that have been and will continue to be implemented to improve its procedures and controls over the Program. The City will continue to work with HUD's Columbus Office of Community Development and Planning to develop a detailed written action plan with an implementation schedule as per HUD's regulations at 24 CFR 92.551 (c). The City will also work with HUD's Columbus Office to develop a format for the reports.

**Finding 2: Controls over the City's Program Contributions Were Inadequate**

*The City inappropriately reported nearly \$2.6 million in Program contributions in HUD's system from 31 Habitat projects during Program years 2004 through 2007 that did not qualify as affordable housing.*

*Contrary to HUD's requirements, the City did not ensure that it implemented sufficient resale or recapture requirements in its restrictive covenants with Habitat or its consolidated plans.*

**City Response to Finding 2**

**Consolidated Plan**

In order to meet the requirements of 24CFR 92.254, provided in the Narrative Responses in the City's current Action Plan, the City has written "Resale or Recapture Provisions are stated in each contract and enforced through deed restrictions or promissory notes." As these actions have been questioned by the HUD Inspector General as fully meeting the requirements of 24CFR 92.254, the City will state the applicable resale or recapture requirements for each program for acquisition by a household in both the Narrative Responses in the City's 2009 Action Plan and in the 2010-2014 Consolidated Plan. Resale or recapture provisions will also continue to be stated in each contract and enforced through deed restrictions or promissory notes. The City will consult with the Columbus HUD Office to ensure the format and language meet the requirements of 24CFR 92.254.

**Comment 2**

**Resale/Recapture Provisions**

The City maintains that the 31 Habitat projects do qualify as affordable housing. This is clearly documented by the sales prices of the units and the income of the buyers. It is also well known nationally and internationally that the sole mission of Habitat for Humanity is to provide affordable housing.

**Comment 2**

Although the Audit cites insufficient resale/recapture provisions in the City's restrictive covenants or its consolidated plans to disqualify the units as affordable housing, the City believes that the HOME funds invested in each unit are protected.

**Comment 2**

**Comment 2**

For each of the 31 projects in question, the City and Cincinnati Habitat executed a Funding Agreement and Cincinnati Habitat also executed a Restrictive Covenant, approved as to form, by the City of Cincinnati's Law Department. Additionally, due

**Ref to OIG Evaluation**

**Auditee Comments**

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**Comment 2**

to the level of HOME funding assistance provided to each unit, the 31 Cincinnati Habitat for Humanity projects only have a 5-year affordability period. The resale requirements are stated in the Restrictive Covenant and in Sections 105 and 106 of the Funding Agreement. The Restrictive Covenant states that "....the Property shall be made available only to a buyer whose family qualifies as a low-income family and will use the property as its principal place of residence." The resale restrictions in Section 106 of the contract include ".....the housing will be available and affordable to a reasonable range of low-income home buyers; resale shall be to a buyer whose family qualifies as a low income family that will use the property as its principal place of residence; the original owner shall be afforded a fair return on investment."

**Comment 2**

The Resale method was selected because of two primary reasons: a) Cincinnati Habitat receives HOME funds per unit (average of \$7,097 for the 31 units) as a developer subsidy; b) Cincinnati Habitat's mission is to provide affordable housing and the resale method is more likely to ensure that each unit would remain affordable during the period of affordability (i.e., 5 years from the date of project completion). Under this method, it is incumbent upon the City to ensure that in the event of a sale, the City approves the new buyer as low-income and that the seller receives a fair return on his/her investment. The City believes that the equity sharing provisions contained within each of the homebuyer's deeds meet the requirements of the HOME program. To preserve affordability, Cincinnati Habitat has the Right of First Refusal for a period of 10 years (extending beyond the City's 5-year affordability period). Additionally, during years 1-5, should the property owner sell the property, they (the property owner) are entitled to 25% of the net proceeds after the mortgage and principal payment.

**Comment 2**

Although the City believes and can demonstrate that these units have, in fact, continued to qualify as affordable housing during the affordability time period elapsed to date, the City intends to discuss this issue with Cincinnati Habitat for Humanity and the City's Law Department and find mutually agreed upon ways to strengthen the language in the restrictive covenant.

**Finding 2 – Recommendation 2A**

*Remove the \$2,558,840 in Program contributions from HUD's System for the contributions that it incorrectly reported in HUD's System for Program Years 2004 through 2007.*

**City Response to Recommendation 2A**

The \$2,558,840 in Program contributions reported for years 2004 through 2007 are from 31 Habitat projects. The contributions included cash donations, gifts-in-kind and volunteer labor. The sole reason that was cited in the audit report to disqualify these contributions is that the City did not ensure that it implemented sufficient resale or recapture requirements in its restrictive covenants with Habitat or its consolidated plans. Therefore, the City could not ensure that the projects would continue to qualify as affordable housing during the projects' affordability periods. Essentially, if the 31 Habitat projects do not qualify as affordable housing, the City

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cannot include the match contributions reported. The City believes that the restrictive covenant and deed restriction placed on each property adequately protects the Funds for the entire affordability period.

**Comment 2**

The City intends to work with Habitat for Humanity and with HUD's Columbus Office of Community Development and Planning to demonstrate that the projects did qualify as affordable housing during 2004 through 2007 and will continue to qualify as affordable housing during the 5-year period of affordability.

**Recommendation 2B**

*Provide supporting documentation or remove \$43,240 in Program contributions (\$2,602,080 in excess contributions less \$2,558,840 for incorrectly reported contributions) from HUD's System for the more than \$40,000 in excess contributions for which the City could not provide supporting documentation.*

**City Response – Recommendation 2B**

The HUD Inspector General has questioned the sufficiency of the documentation for \$43,240 in excess program contributions. The City is working to provide sufficient documentation to support the \$43,240 in contributions to the Program.

**Recommendation 2C**

*Provide supporting documentation or remove \$1,778,862 in Program contributions (\$1,822,102 in unsupported contributions less \$43,240 in unsupported excess contributions) from HUD's System for the nearly \$1.8 million in required contributions in which the City could not provide sufficient supporting documentation. If the City cannot provide sufficient supporting documentation, it should obtain \$1,778,862 in Program contributions from nonfederal funds for housing that qualifies as affordable housing under the Program.*

**City Response – Recommendation 2C**

The City is working to provide additional supporting documentation for the \$1,822,102 in Program contributions. This includes but is not limited to obtaining property tax records for tax abatements on affordable housing units. We anticipate receiving all or part of the required documentation within 90-120 days of the date of this report.

**Recommendation 2D**

*Reimburse its Program from nonfederal funds for the \$220,026 in Program funds used during Program years 2004 through 2007 for the 31 Habitat projects in which the City did not sufficiently protect the Program funds.*

**City Response - Recommendation 2D**

The City contends that the funds used in the 31 Habitat projects were sufficiently protected. However, the City will work with HUD Columbus to resolve this issue.

**Comment 2**

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 3**

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**Recommendation 2E**

*Decommit the Program funds inappropriately committed to the six Habitat projects, which have remaining balances in HUD's System totaling \$12,146.*

**City Response – Recommendation 2E**

The audit report does not cite specific IDIS numbers for the six projects in question. However, the City will determine all Habitat projects that have a current balance. The City does not believe that funds were inappropriately committed to six Habitat projects as previously stated and will work with the Columbus HUD office to demonstrate that these projects qualify as affordable housing.

**Recommendation 2F**

*Implement adequate procedures and controls to ensure that the City obtains sufficient Program contributions from nonfederal funds for housing that qualifies as affordable housing under the program.*

**City Response – Recommendation 2F**

Historically the City has provided excess Program contributions. Based on the recommendations herein, the City will revise its management, reporting, and record-keeping procedures for all Program contributions. The City plans to work closely with HUD Columbus to assure that all Program contributions are eligible and properly supported.

**Recommendation 2G**

*Implement adequate procedures and controls to ensure that housing assistance is provided in accordance with HUD's requirements.*

**City Response – 2G**

The City has demonstrated its commitment to resolving all outstanding issues with HUD's Columbus Office of Community Development and Planning. The City has also documented measures that have been, and will continue to be, implemented to improve its procedures and controls over the HOME Program. Many of the issues raised in Phase 3 Audit will require close collaboration with the City's Office of Budget and Evaluation and the City's Law Department to strengthen language contained in our Consolidated Plan and Resale/Recapture documents to ensure compliance with all applicable federal regulations. City representatives will attend an upcoming Effective Written Agreements training to be held in November 2008 to further enhance our knowledge in this area.

**Comment 1**

The City will be working closely with HUD's Columbus Office of Community Development and Planning as new procedures and controls are adopted. Additionally a training schedule for staff implemented in 2007 will continue. As a result of the increased training opportunities, in 2008, five (5) staff members received certification in HOME regulations with an additional three (3) currently reviewing HOME regulations to assume monitoring duties.



**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 1**

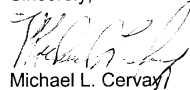
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In closing, it is my hope that HUD will determine that the City of Cincinnati made appropriate use of its HUD funds and has recognized our intent to increase our understanding and enhance operations relative to use of future funds. It is also my hope that our plans indicate to HUD that the City is willing to improve upon its current systems and relationships relative to federal programs. In 2007 and 2008 combined, eight staff has attended an average of two federal HOME and/or CDBG training opportunities that will build the department's capacity to handle federal funds. As our department undergoes a restructuring of responsibilities within divisions over the next year, a complete monitoring section will be in place to complete our checks and balances.

The City looks forward to a continued partnership with HUD in order to achieve our common goals of providing appropriate assistance to eligible participants and to increase homeownership in the City of Cincinnati. Should you need additional information, please don't hesitate to contact me at (513) 352-1947, or via email at [Michael.Cervay@cincinnati-oh.gov](mailto:Michael.Cervay@cincinnati-oh.gov), or Dwendolyn Chester, Deputy Director, at (513) 352-4881 or [Dwendolyn.chester@cincinnati-oh.gov](mailto:Dwendolyn.chester@cincinnati-oh.gov).

Sincerely,



Michael L. Cervay  
Director

- Cc: Mark Mallory, Mayor, City of Cincinnati  
Milton Dohoney, Jr., City Manager, City of Cincinnati  
John P. Curp, Solicitor, City of Cincinnati  
Lea Carroll, Director, Office of Budget and Evaluation, City of Cincinnati  
Joe Gray, Director, Finance, City of Cincinnati  
Dwendolyn Chester, Deputy Director, Community Development, City of Cincinnati  
Herman Bowling, Housing Manager, Community Development, City of Cincinnati  
Oren Henry, Community Development Administrator, City of Cincinnati  
Jorgelle Lawson, Director, Office of Community Development and Planning, HUD Columbus  
Richard Hendershot, Program Manager, Office of Community Development and Planning, HUD Columbus  
Robert Milburn, Program Officer, Office of Community Development and Planning, HUD Columbus

## OIG Evaluation of Auditee Comments

**Comment 1** The City's commitment to resolve all outstanding issues from our prior audit reports and implement a detailed comprehensive written action plan should improve its procedures and controls to ensure that the City operates its Program in accordance with HUD's and its own requirements.

**Comment 2** Contrary to HUD's requirements, the City did not ensure that it implemented sufficient resale or recapture requirements in its restrictive covenants with Habitat or its consolidated plans. Therefore, it could not ensure that the projects would continue to qualify as affordable housing during the projects' affordability periods.

HUD's regulations at 24 CFR 92.254(a) state that Program housing that is for acquisition by a household must meet the affordability requirements of 24 CFR 92.254(a). Section 92.254(a)(5) states that to ensure affordability, a participating jurisdiction must impose either resale or recapture requirements that comply with the standards of section 92.254(a)(5) and set forth the requirements in its consolidated plan. Section 92.254(a)(5)(i) states that a participating jurisdiction's resale requirements must ensure, if the housing does not continue to be the principal residence of the household for the duration of the period of affordability, that the housing will remain affordable to a reasonable range of low-income homebuyers. Deed restrictions, covenants running with the land, or other similar mechanisms must be used to impose the resale requirements. Section 92.254(a)(5)(ii) states that a participating jurisdiction's recapture requirements must ensure that the participating jurisdiction recoups all or a portion of the Program assistance to the homebuyers if the housing does not continue to be the principal residence of the household for the duration of the period of affordability.

**Comment 3** We provided the City and HUD a supporting schedule on August 18, 2008, showing the six projects that had remaining balances in HUD's System totaling more than \$12,146 in Program funds.

## Appendix C

### FEDERAL REQUIREMENTS

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#### Finding 1

HUD's regulations at 24 CFR 92.504(a) state that a participating jurisdiction is responsible for managing the day-to-day operations of its Program, ensuring that Program funds are used in accordance with all Program requirements and written agreements, and taking appropriate action when performance problems arise. The use of subrecipients or contractors does not relieve the participating jurisdiction of this responsibility.

HUD's regulations at 24 CFR 92.550(a) state that HUD will review the performance of each participating jurisdiction in carrying out its responsibilities under 24 CFR Part 92 whenever determined necessary by HUD but at least annually. HUD may also consider relevant information pertaining to a participating jurisdiction's performance gained from other sources.

HUD's regulations at 24 CFR 92.551(c) state that corrective or remedial actions for a participating jurisdiction's performance deficiency or a failure to meet a provision of 24 CFR Part 92 will be designed to prevent its continuation; mitigate, to the extent possible, its adverse effects or consequences; and prevent its recurrence. Section 92.551(c)(1) states that HUD may instruct the participating jurisdiction to submit and comply with proposals for action to correct, mitigate, and prevent a performance deficiency to include the following:

- ❖ Preparing and following a schedule of actions for carrying out the affected activities, consisting of schedules, timetables, and milestones necessary to implement the affected activities;
- ❖ Establishing and following a management plan that assigns responsibilities for carrying out remedial actions;
- ❖ Canceling or revising activities likely to be affected by the performance deficiency before expending Program funds for the activities;
- ❖ Reprogramming Program funds that have not yet been expended for affected activities to other eligible activities;
- ❖ Reimbursing its HOME investment trust fund local account (local account) in any amount not used in accordance with the requirements of 24 CFR Part 92;
- ❖ Suspending the disbursement of Program funds for affected activities; and
- ❖ Making matching contributions as draws are made from its treasury account.

HUD's regulations at 24 CFR 92.551(c)(2) state that HUD may also change the method of payment to a participating jurisdiction from an advance to a reimbursement basis and take other remedies that may be legally available.

## **Finding 2**

Title II of the Cranston-Gonzalez National Affordable Housing Act (Act), as amended, section 220(a), and HUD's regulations at 24 CFR 92.218(a) state that each participating jurisdiction must make contributions to housing that qualifies as affordable housing under the Program during a fiscal year. The contributions must total not less than 25 percent of the Program funds drawn from the participating jurisdiction's treasury account during a fiscal year.

Title II of the Act, as amended, section 223, states that if the HUD finds after reasonable notice and opportunity for hearing that a participating jurisdiction has failed to comply substantially with any provision of the Act and until HUD is satisfied that there is no longer any such failure to comply, HUD shall reduce the Program funds in the participating jurisdiction's treasury account by the amount of any expenditures that were not in accordance with the requirements of the Act.

HUD's regulations at 24 CFR 92.552(a) state that if HUD finds after reasonable notice and opportunity for hearing that a participating jurisdiction has failed to comply with any provision of 24 CFR Part 92 and until HUD is satisfied that there is no longer any such failure to comply, HUD shall reduce the Program funds in the participating jurisdiction's treasury account by the amount of any expenditures that were not in accordance with the requirements of 24 CFR Part 92.

HUD's regulations at 24 CFR 92.218(a) state that each participating jurisdiction must make contributions to housing that qualifies as affordable housing under the Program during a fiscal year. The contributions must total not less than 25 percent of the Program funds drawn from the participating jurisdiction's treasury account during a fiscal year.

HUD's regulations at 24 CFR 92.220(a)(1) state that for a cash contribution to be eligible as a Program contribution, nonfederal funds must be contributed permanently to the Program. Therefore, to receive match credit for the full amount of a loan to a Program project, all repayment, interest, or other return on investment of the contribution must be deposited in a participating jurisdiction's local account to be used for eligible Program activities. HUD's regulations at 24 CFR 92.220(a)(1)(iii) state that the grant equivalent of a below-market interest rate loan, from nonborrowed funds, to a project that is not repayable to a participating jurisdiction's local account may be counted as a cash contribution as follows: the present discounted value of the yield forgone (a rate equal to the 10-year Treasury note rate plus 200 basis points for one- to four-unit housing financed with a fixed interest rate mortgage).

HUD's regulations at 24 CFR 92.220(a)(3)(ii) state that donated property acquired with federal assistance specifically for a Program project may provide a partial contribution. The property must be acquired with federal assistance at demonstrably below the appraised value and acknowledged by the seller as a donation to affordable housing at the time of the acquisition. The amount of the contribution is the difference between the acquisition price and the appraised value at the time of acquisition.

HUD's regulations at 24 CFR 92.220(a)(6) state that the reasonable value of donated site-preparation and construction materials, not acquired with federal funds, are eligible as Program contributions.

HUD's regulations at 24 CFR 92.222(a)(1) state that if a participating jurisdiction meets one of the two following distress factors, poverty rate or per capita income, the participating jurisdiction's Program contribution will be reduced by 50 percent.

HUD's regulations at 24 CFR 92.254(a) state that Program housing that is for acquisition by a household must meet the affordability requirements of 24 CFR 92.254(a). Section 92.254(a)(5) states that to ensure affordability, a participating jurisdiction must impose either resale or recapture requirements that comply with the standards of section 92.254(a)(5) and set forth the requirements in its consolidated plan. Section 92.254(a)(5)(i) states that a participating jurisdiction's resale requirements must ensure, if the housing does not continue to be the principal residence of the household for the duration of the period of affordability, that the housing is made available for subsequent purchase only to a homebuyer whose household qualifies as a low-income family and will use the property as its principal residence. The resale requirements must also ensure that the price at resale provides the original Program-assisted owner a fair return on investment and ensure that the housing will remain affordable to a reasonable range of low-income homebuyers. Deed restrictions, covenants running with the land, or other similar mechanisms must be used to impose the resale requirements. Section 92.254(a)(5)(ii) states that a participating jurisdiction's recapture requirements must ensure that the participating jurisdiction recoups all or a portion of the Program assistance to the homebuyers if the housing does not continue to be the principal residence of the household for the duration of the period of affordability.

HUD's regulations at 24 CFR 92.508(a) state that a participating jurisdiction must establish and maintain sufficient records to enable HUD to determine whether the participating jurisdiction has met the requirements of 24 CFR Part 92. The participating jurisdiction must maintain records demonstrating compliance with the matching requirements of 24 CFR 92.220, including a running log and project records documenting the type and amount of Program contributions by project.

Section V of HUD's Community Planning and Development Notice 97-03 states that to be considered eligible as a Program contribution, a contribution must be made from nonfederal sources and must be a permanent contribution to a Program-assisted project or to Program-eligible housing. Section V.B states that documentation of Program contributions in the form of forgiven taxes, fees, or charges must include a letter from the entity granting forgiveness and as appropriate, establishing the value of the contribution. To calculate the present discounted value of taxes, fees, or charges that are forgiven in future years, a participating jurisdiction is to use a property's full market value as the taxable basis, must document any assumptions and the basis upon which the assumptions were made, and should be able to demonstrate that the assumptions are reasonable.

Section VII of HUD's Community Planning and Development Notice 97-03 states that the value of forgone taxes is credited at the time a local government officially forgoes the taxes and

notifies the project owner of the forgone taxes. Section XI states that a participating jurisdiction's Program contribution log should serve as the basis for reporting its Program contributions as part of its consolidated report. However, the participating jurisdiction is also required to maintain documentation in its project files to establish that each contribution is eligible, made to a Program-assisted or Program-eligible project, and has been valued in accordance with HUD's Program regulations and with customary and reasonable means of establishing value.