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

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

SUBJECT: The Office of Block Grant Assistance Lacked Adequate Controls Over the
Inclusion of Special Conditions in Neighborhood Stabilization Program Grant
Agreements

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) Office of Block Grant Assistance's (Office) controls over special conditions in Neighborhood Stabilization Program 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 Neighborhood Stabilization Program grant agreements with high-risk grantees.

What We Found

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

What We Recommend

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

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 to HUD's Deputy Assistant Secretary for Grant Programs during the audit. We held an exit conference with the Deputy Assistant Secretary on March 19, 2010.

We asked the Deputy Assistant Secretary to provide comments on our discussion draft audit report by March 28, 2010. During the exit conference, the Deputy Assistant Secretary said that she agreed with the finding in the discussion draft audit report that HUD should have considered risk signals such as monitoring and audit findings for the Neighborhood Stabilization Program grantees' non-Block Grant community planning and development programs when it determined whether to include special conditions in Program grant agreements with grantees. However, the Deputy Assistant Secretary planned to provide alternative actions to our recommendation as part of the audit resolution process. Therefore, comments were not provided on the discussion draft audit report.

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BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program. Authorized under section 2301 of Title III of the Housing and Economic Recovery Act of 2008 (Act) as amended, Congress appropriated \$4 billion for the Neighborhood Stabilization Program to provide grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and to rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem the decline in value of neighboring homes. The Act states that amounts appropriated, revenues generated, or amounts otherwise made available to States and units of general local government under section 2301 shall be treated as though such funds were Community Development Block Grant (Block Grant) funds under Title I of the Housing and Community Development Act of 1974. The U.S. Department of Housing and Urban Development (HUD) allocated more than \$3.9 billion in Neighborhood Stabilization Program funds to more than 300 grantees.

Congress amended the Neighborhood Stabilization Program and increased its funding as part of the American Recovery and Reinvestment Act of 2009 (Recovery Act). The Recovery Act provided HUD an additional \$2 billion in Neighborhood Stabilization Program funds to competitively award to States, local governments, nonprofit organizations, or consortia of nonprofit organizations, which could submit proposals in partnership with for-profit organizations. The Recovery Act also states that HUD's Secretary may use up to 10 percent of the funds for capacity building of and support for local communities receiving Neighborhood Stabilization Program funding under the Act or the Recovery Act. Further, up to 1 percent of the funds shall be available to HUD for staffing, training, providing technical assistance, technology, monitoring, travel, enforcement, research, and evaluation activities. In January 2010, HUD awarded 56 organizations more than \$1.9 billion in funds through a competitive process. In February 2010, HUD signed and sent grant agreements to the 56 grantees for execution. HUD's Office of Block Grant Assistance (Office) has oversight responsibility for the Neighborhood Stabilization Program.

HUD could impose special conditions if a Neighborhood Stabilization Program grantee (1) had a history of unsatisfactory performance, (2) was not financially stable, (3) had a management system which did not meet management standards, (4) had not conformed to terms and conditions of previous awards, or (5) was otherwise not responsible. Special conditions may include (1) payment on a reimbursement basis, (2) withholding authority to proceed to the next phase until receipt of evidence of acceptable performance within a given funding period, (3) requiring additional, more detailed financial reports, (4) additional project monitoring, (5) requiring the grantee to obtain technical or management assistance, or (6) establishing additional prior approvals.

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 Neighborhood Stabilization Program grant agreements with high-risk grantees.

RESULTS OF AUDIT

Finding: HUD's Office Did Not Ensure That Field Offices Included Special Conditions in Neighborhood Stabilization Program Grant Agreements With High-Risk Grantees

HUD's field offices used different procedures for including special conditions in Neighborhood Stabilization Program grant agreements under the Act. This condition occurred because HUD's Office lacked adequate controls over its Neighborhood Stabilization Program under the Act to ensure that HUD's field offices included special conditions in their Program grant agreements with high-risk grantees. As a result, HUD's Office did not ensure that the field offices were consistent in their consideration and inclusion of special conditions in Neighborhood Stabilization Program grant agreements with grantees under the Act. Further, HUD's Office lacked assurance that special conditions were included in all of the Neighborhood Stabilization Program grant agreements with high-risk grantees.

HUD's Office Did Not Ensure That Special Conditions Were Included in All Program Grant Agreements With High-Risk Grantees

The Federal Register, dated October 6, 2008, stated that for Neighborhood Stabilization Program grantees under the Act that HUD determined were high risk, HUD would apply additional grant conditions.

On November 26, 2008, HUD's former General Deputy Assistant Secretary for Community Planning and Development provided procedures for the review and processing of Neighborhood Stabilization Program substantial action plan amendments to all of the directors of HUD's field offices. The procedures stated that the field offices should be prepared to recommend grant conditions deemed necessary to ensure adequate control of Neighborhood Stabilization Program funds. Further, the procedures mentioned that a list of potential grant conditions would be forwarded to the directors of the field offices under separate cover and that no grant condition could be imposed without specific approval from headquarters.

On February 24, 2009, HUD's Director of Field Management provided guidance on Neighborhood Stabilization Program grant agreements to all of the directors of the field offices. The guidance stated that if a grantee's Neighborhood Stabilization Program funds totaled at least three times its fiscal year 2008 Block Grant fund allocation or a grantee had unresolved monitoring findings or other

serious actions, a special condition must be included in the Program grant agreement with the grantee. The guidance also included that a special condition applies to the Neighborhood Stabilization Program grant agreement due to past performance in the Block Grant program. The field offices still needed approval from headquarters to include a special condition in a Program grant agreement with a grantee.

The Assistant Director of Financial Management in HUD's Office stated that the special conditions referred to the Block Grant program since Neighborhood Stabilization Program funds were considered a special allocation of Block Grant funds. However, if a grantee had a history of unsatisfactory performance in another community planning and development program, such as the HOME Investment Partnerships Program (HOME), and that unsatisfactory performance was applicable to the grantee's Neighborhood Stabilization Program, it would be appropriate to include special conditions in the Neighborhood Stabilization Program grant agreement.

HUD's field offices used different procedures for including special conditions in Neighborhood Stabilization Program grant agreements with high-risk grantees. Previous discussions with two directors of field offices indicated that the two field offices only considered grantees' past performance or other serious actions in their Block Grant program when determining whether to include special conditions in the Neighborhood Stabilization Program grant agreements with grantees. The field offices did not consider grantees' past performance or other serious actions in their HOME, Emergency Shelter Grant, and Supportive Housing programs when determining whether to include special conditions in the Neighborhood Stabilization Program grant agreements with grantees.

For example, HUD's Columbus Office of Community Planning and Development did not place special conditions in its Neighborhood Stabilization Program grant agreement with the City of Cincinnati (City) even though the City had executed an agreement with HUD and the U.S. Department of Justice to reimburse its HOME program \$3.95 million to settle all outstanding issues regarding the City's improper use of HOME funds for the Huntington Meadows apartment project. In addition, we identified significant deficiencies in the City's administration of its HOME program, which included issues applicable to its Neighborhood Stabilization Program. HUD's Columbus Office of Community Planning and Development did not place special conditions in its Neighborhood Stabilization Program grant agreement with the City because the Act stated that the Neighborhood Stabilization Program funds should generally be treated as though they were Block Grant funds and HUD's Columbus Office of Community Planning and Development had not previously identified significant issues with the City's Block Grant program (see Office of Inspector General (OIG) Audit Memorandum 2009-CH-1801).

We requested information and documentation from the 10 directors of the field offices in HUD's regional offices regarding the inclusion of special conditions in Neighborhood Stabilization Program grant agreements with high-risk grantees. As of March 5, 2010, only 6 of the 10 field offices had responded to our request. Based on the information and documentation that the six field offices provided, all six of the field offices considered grantees' past performance or other serious actions in their Block Grant and HOME, Emergency Shelter Grant, and/or Supportive Housing programs when determining whether to include special conditions in the Neighborhood Stabilization Program grant agreements with grantees. Further, HUD's Fort Worth Office of Community Planning and Development included special conditions in Neighborhood Stabilization Program grant agreements with two grantees due to open findings and past performance issues in the grantees' HOME programs.

HUD's Chicago Office of Community Planning and Development did not respond to our request for information and documentation. However, through our previous review of Cook County's (County) capacity to administer its Neighborhood Stabilization Program, we found that HUD's Chicago Office of Community Planning and Development did not place special conditions in its Neighborhood Stabilization Program grant agreement with the County even though we identified significant deficiencies in the County's administration of its HOME program, which included issues applicable to the County's Neighborhood Stabilization Program. The Director of HUD's Chicago Office of Community Planning and Development said that although there were previous issues identified with the County's HOME program, he did not believe that special conditions were necessary since his office was handling the deficiencies with the County's HOME program through the management decision process and HOME and the Neighborhood Stabilization Program were separate programs (see OIG Audit Memorandum 2009-CH-1802).

All of HUD's field offices from which we were able to obtain information and/or documentation stated that they considered grantees' past performance or other serious actions in their Block Grant program when determining whether to include special conditions in the Neighborhood Stabilization Program grant agreements with grantees. However, they were not consistent in their consideration and inclusion of special conditions in Neighborhood Stabilization Program grant agreements with high-risk grantees.

HUD's Office stated that it also used mechanisms other than including special conditions in Neighborhood Stabilization Program grant agreements to ensure that Program funds were used appropriately. The mechanisms included monitoring, along with risk analyses, to determine high-risk grantees that need monitoring and technical assistance. Technical assistance included on-site needs assessments for high-risk Neighborhood Stabilization Program grantees, on-site consultation and training, group training and workshops, and Web materials. Although the monitoring process and technical assistance should aid grantees in using

Neighborhood Stabilization Program funds appropriately, these mechanisms were not sufficient substitutes for including special conditions in Program grant agreements. Monitoring had not occurred as of February 5, 2010, which was more than 10 months after HUD's field offices entered into Neighborhood Stabilization Program grant agreements with grantees for Program funds that must be obligated within 18 months of executing the grant agreements. Further, technical assistance did not consider grantees' past performance in HUD's non-Block Grant community planning and development programs.

HUD's Office Lacked Adequate Procedures and Controls

The weakness described above occurred because HUD's Office lacked adequate controls over its Neighborhood Stabilization Program under the Act to ensure that HUD's field offices included special conditions in their Program grant agreements with high-risk grantees.

The guidance provided by HUD's Director of Field Management on February 24, 2009, inappropriately limited the inclusion of special conditions in a grantee's Neighborhood Stabilization Program grant agreement based on a grantee's past performance in its Block Grant program. HUD's Director of Block Grant Assistance said that the Act stated that Neighborhood Stabilization Program funds should be treated as Block Grant funds. The Director also said that it would not have been appropriate to consider grantees' past performance or other serious actions in their other community planning and development programs when determining whether to include special conditions in the Neighborhood Stabilization Program grant agreements with grantees.

However, some of the eligible activities and requirements for the HOME program are similar to some of the eligible activities and requirements for the Neighborhood Stabilization Program. For example, both HOME and Neighborhood Stabilization Program funds may be used for the purchase and rehabilitation of homes. Additionally, both the HOME program and the Neighborhood Stabilization Program limit the amount of income households may earn to receive assistance under the programs.

Further, the Assistant Director of Financial Management in HUD's Office approved HUD's Fort Worth Office of Community Planning and Development's inclusion of special conditions in the Neighborhood Stabilization Program grant agreements with the two grantees due to open findings and past performance issues in the grantees' HOME programs.

In addition, section h(2) of HUD's Neighborhood Stabilization Program plan for the Recovery Act states that high-risk grantees are those that are new to the Block Grant program or habitual poor Block Grant and HOME program performers or

have open monitoring or audit findings, significant funding increases, recent critical staff turnover, or extremely high congressional or national media interest. The requirements for the Neighborhood Stabilization Program under the Act and the Recovery Act are the same. Therefore, if it was appropriate to consider a grantee's past performance in its HOME program for the Neighborhood Stabilization Program under the Recovery Act, it would have been appropriate to consider a grantee's past performance in its non-Block Grant community planning and development programs for the Neighborhood Stabilization Program under the Act.

Conclusion

As previously mentioned, HUD's Office lacked adequate controls over its Neighborhood Stabilization Program under the Act to ensure that HUD's field offices included special conditions in their Program grant agreements with high-risk grantees. As a result, HUD's field offices were not consistent in their consideration and inclusion of special conditions in Neighborhood Stabilization Program grant agreements with grantees under the Act. Further, HUD's Office lacked assurance that special conditions were included in all of the Neighborhood Stabilization Program grant agreements with high-risk grantees.

In addition, HUD awarded 56 organizations more than \$1.9 billion in Neighborhood Stabilization Program funds under the Recovery Act in January 2010. HUD's Director of Block Grant Assistance said that HUD's Office planned to discuss Program grantees' past performance with HUD's field offices and include special conditions in its Program grant agreements with grantees as appropriate. However, as of February 4, 2010, HUD's Office did not have written policies, procedures, and controls for the inclusion of special conditions in its Program grant agreements with grantees. Therefore, there is a risk that under the Recovery Act, HUD's Office did not include special conditions in all of its Program grant agreements with high-risk grantees. On February 5, 2010, we informed HUD's Office of our concern through a draft audit finding outline. We did not include a recommendation in this report regarding our concern since as of March 5, 2010, our Atlanta regional Office of Audit was reviewing whether HUD's Office included special conditions in all of its Program grant agreements with high-risk grantees.

Recommendation

We recommend that HUD's Deputy Assistant Secretary for Grant Programs require the Office to

- 1A. Determine whether Neighborhood Stabilization Program grantees under the Act are high risk by considering grantees' past performance or other serious actions in their HOME, Emergency Shelter Grant, and/or

Supportive Housing programs. If the Neighborhood Stabilization Program grantees are high risk, they should be required to develop and implement management plans for their Programs that will include but not be limited to describing how unresolved HOME, Emergency Shelter Grant, and/or Supportive Housing program performance issues were resolved or are being resolved and explain whether the issues will impact the administration of their Neighborhood Stabilization Programs.

SCOPE AND METHODOLOGY

To accomplish our objective, we reviewed

- Applicable laws; the Federal Register, dated October 6, 2008, and June 19, 2009; HUD's regulations at 24 CFR (Code of Federal Regulations) Parts 84, 85, 92, and 570; the notice of funding availability for the Neighborhood Stabilization Program under the Recovery Act, dated May 4, 2009; HUD's Community Planning and Development Notice 09-04; HUD's Neighborhood Stabilization Program plan for the Recovery Act; HUD's Community Planning and Development Monitoring Handbook 6509.2, REV-5, CHG-2; HUD's draft Community Planning and Development Monitoring Handbook 6509.2, REV-6; HUD's Office's and field offices' information regarding the Neighborhood Stabilization Program and Program grantees; and OIG Audit Memorandums 2009-CH-1801, issued July 29, 2009, and 2009-CH-1802, issued September 17, 2009.
- HUD's Office's list of Neighborhood Stabilization Program grantees for which field offices included special conditions in their grant agreements with the grantees and lists of applicants for Neighborhood Stabilization Program funds under the Recovery Act.
- HUD's field offices' Neighborhood Stabilization Program grant agreements with grantees and monitoring reports for grantees' community planning and development programs.

In addition, we interviewed HUD's staff.

Previous discussions with two directors of field offices indicated that the two field offices only considered grantees' past performance or other serious actions in their Block Grant program when determining whether to include special conditions in the Neighborhood Stabilization Program grant agreements with grantees. Therefore, we requested information and documentation from the 10 directors of the field offices in HUD's regional offices regarding the inclusion of special conditions in Neighborhood Stabilization Program grant agreements with high-risk grantees.

We performed our audit work from October 2009 through February 2010 at HUD's Chicago regional office. The audit covered the period from July 2008 through September 2009 and was expanded as determined necessary.

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 finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

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 objective:

- 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 that the following item is a significant weakness:

- HUD's Office lacked adequate controls over its Neighborhood Stabilization Program under the Act to ensure that HUD's field offices included special conditions in their Program grant agreements with high-risk grantees.

APPENDIX

Appendix A

HUD'S REQUIREMENTS

The Federal Register, dated October 6, 2008, stated that for Neighborhood Stabilization Program grantees under the Act that HUD determined were high risk in accordance with HUD's regulations at 24 CFR 85.12(a), HUD would apply additional grant conditions in accordance with 24 CFR 85.12(b).

Appendix I, section D, of HUD's notice of funding availability for the Neighborhood Stabilization Program under the Recovery Act states that for Program recipients that HUD determines to be high risk in accordance with 24 CFR 84.14 and 85.12, HUD will apply additional grant conditions in accordance with 24 CFR 84.14 and 85.12.

HUD's regulations at 24 CFR 84.14 state that HUD may impose additional requirements, as needed, if an applicant or recipient (1) has a history of poor performance, (2) is not financially stable, (3) has a management system that does not meet the standards prescribed in 24 CFR Part 84, (4) has not conformed to the terms and conditions of a previous award, or (5) is not otherwise responsible.

HUD's regulations at 24 CFR 85.12(a) state that a grantee may be considered high risk if it (1) has a history of unsatisfactory performance, (2) is not financially stable, (3) has a management system which does not meet the management standards set forth in 24 CFR Part 85, (4) has not conformed to terms and conditions of previous awards, or (5) is otherwise not responsible. If the awarding agency determines that an award will be made, special conditions and/or restrictions shall correspond to the high-risk condition and shall be included in the award. Section 85.12(b) states that special conditions or restrictions may include (1) payment on a reimbursement basis, (2) withholding authority to proceed to the next phase until receipt of evidence of acceptable performance within a given funding period, (3) requiring additional, more detailed financial reports, (4) additional project monitoring, (5) requiring the grantee to obtain technical or management assistance, or (6) establishing additional prior approvals.

On November 26, 2008, HUD's former General Deputy Assistant Secretary for Community Planning and Development provided procedures for the review and processing of Neighborhood Stabilization Program substantial action plan amendments to all of the directors of HUD's field offices. The procedures stated that the field offices should be prepared to recommend grant conditions deemed necessary to ensure adequate control of Neighborhood Stabilization Program funds and the Federal Register, dated October 6, 2008, specifically authorized HUD to apply grant conditions to grantees deemed to be high risk pursuant to 24 CFR 85.12(a). Further, the procedures mentioned that a list of potential grant conditions would be forwarded to the directors

of the field offices under separate cover and that no grant condition could be imposed without specific approval from headquarters.

On February 24, 2009, HUD's Director of Field Management provided guidance on Neighborhood Stabilization Program grant agreements to all of the directors of the field offices. The guidance addressed when a special condition must be included in a Neighborhood Stabilization Program grant agreement with a grantee. The guidance stated that if a grantee's Neighborhood Stabilization Program funds totaled at least three times its fiscal year 2008 Block Grant fund allocation or a grantee had unresolved monitoring findings or other serious actions, a special condition must be included in the Program grant agreement with the grantee. The guidance requested that the directors of the field offices contact the Assistant Director of Financial Management in HUD's Office to discuss the inclusion of a special condition in a Neighborhood Stabilization Program grant agreement with a grantee. The guidance also included the following standard language to be included in grant agreements:

Pursuant to 24 CFR 85.12(a)(1), (2), (4), or (5), a special condition applies to the Neighborhood Stabilization Program grant agreement due to past performance in the Block Grant program. The Neighborhood Stabilization Program grantee shall submit documentation describing how past Block Grant program performance issues have been resolved or are now being resolved and explain how they will not impact the administration of the Neighborhood Stabilization Program. If the Neighborhood Stabilization Program grantee fails to submit such documentation within 60 days from the date HUD signed the Neighborhood Stabilization Program grant agreement, HUD may withhold the Program grantee's authority to incur additional obligations of Program funds or take other actions authorized under 24 CFR 85.12(b).