



Issue Date	September 17, 2010
Audit Report Number	2010-DE-1006

TO: LeRoy Brown, Director, Denver Office of Community Planning and Development, 8AD

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, Kansas City Region, 8AGA

SUBJECT: The City and County of Denver, CO, Did Not Properly Obligate and Report NSP I Funding

HIGHLIGHTS

What We Audited and Why

We audited the City and County of Denver’s (City) Neighborhood Stabilization Program I (NSP I). We selected the City for review based on our risk assessment considering the amount of Housing and Economic Recovery Act of 2008 (HERA) and American Recovery and Reinvestment Act of 2009 NSP funds it received and expended along with other evaluative factors. This review is consistent with the U.S. Department of Housing and Urban Development (HUD) Office of Inspector General (OIG) audit plan to perform audits of grantees receiving NSP funding.

The objectives of the review were to determine whether the City obligated NSP I funding in accordance with HERA rules and regulations and whether the City followed HUD’s NSP reporting regulations and posted quarterly NSP I performance reports on its official Web site.

What We Found

The City improperly obligated more than \$1.5 million of its NSP I funds by recording its funds as obligated in HUD's Disaster Recovery Grant Reporting System (DRGR) without the funds being linked to a specific address and/or household. Additionally, the City did not follow HUD's NSP I reporting regulations. It did not post two quarterly NSP I performance reports on its official Web site within the 30-day requirement.

What We Recommend

We recommend that the Director of the Denver, CO, Office of Community Planning and Development require the City to develop and implement policies and procedures to ensure proper obligation of NSP I funding and deobligate any portion of the more than \$1.5 million in NSP I funds that was not properly obligated. We also recommend that HUD provide technical assistance to the City regarding HUD's reporting requirements to ensure that it posts quarterly NSP I performance reports on its official Web site within the 30-day requirement.

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 the discussion draft of the audit report to the City on September 2, 2010, and requested its comments by September 10, 2010. The City provided its written response on September 10, 2010, and agreed with the findings.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: The City Improperly Obligated More Than \$1.5 Million of Its NSP I Funds Before The Funds Were Committed to Specific Properties	5
Finding 2: The City Did Not Post Two Quarterly NSP I Performance Reports When Required	7
Scope and Methodology	9
Internal Controls	11
Appendixes	
A. Schedule of Funds To Be Put to Better Use	12
B. Auditee Comments and OIG's Evaluation	13

BACKGROUND AND OBJECTIVES

The Neighborhood Stabilization Program (NSP) I was authorized under Title III of the Housing and Economic Recovery Act of 2008 (HERA) and provides grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and to rehabilitate, resell, or redevelop the homes to stabilize neighborhoods and stem declining values in neighboring homes. In the first phase, the U.S. Department of Housing and Urban Development (HUD) allocated more than \$3.9 billion in NSP I funds to grantees.

The City and County of Denver (City) executed a grant agreement on March 20, 2009, with HUD to receive more than \$6 million in NSP I funds. The City has until September 20, 2010 (18 months), to obligate the funds and until March 20, 2013 (48 months), to spend the funds. The City contracted with two subrecipients and two developers for NSP I activities. The City's NSP I budget included the following:

- Nearly \$375,000 to two subrecipients to establish financing mechanisms for the purchase and redevelopment of foreclosed-upon homes and residential properties;
- Nearly \$5.1 million to two developers for the purchase and rehabilitation of abandoned or foreclosed-upon homes or residential properties to sell, rent, and redevelop the homes or properties; and
- Nearly \$606,000 for planning and administration costs.

The objectives of the review were to determine whether the City obligated NSP I funding in accordance with HERA rules and regulations and whether the City followed HUD's NSP reporting regulations and posted quarterly NSP I performance reports on its official Web site.

RESULTS OF AUDIT

Finding 1: The City Improperly Obligated More Than \$1.5 Million of Its NSP I Funds Before The Funds Were Committed to Specific Properties

The City improperly obligated more than \$1.5 million of its NSP I funds before the funds were committed to specific properties. This problem occurred because the City did not have written policies and procedures for obligating NSP I funds in HUD's Disaster Recovery Grant Reporting (DRGR) system. As a result, HUD will recapture any portion of the funds not properly obligated by the September 20, 2010, deadline, and the intended recipients will lose the benefit of the planned activities.

The City Improperly Obligated Its NSP I Funds

The City improperly obligated more than \$1.5 million of its NSP I funds before the funds were committed to specific properties. It obligated NSP I funds based on the contract amount with its developers and subrecipients. These contracts with the developers and subrecipients did not identify specific properties. However, Federal Register Volume 73, No. 194, dated Monday, October 6, 2008, states that funds are obligated when they are linked to specific activities. NSP Policy Alert, Volume 3, April 2010, further states that HUD does not consider NSP funds obligated for a specific activity unless the obligation can be linked to a specific address and/or household.

As of July 29, 2010, the City had obligated more than \$6 million in NSP I funds in HUD's DRGR system when only a little more than \$4.5 million was linked to specific addresses and/or households, which means that more than \$1.5 million was obligated before the funds were committed to specific properties.

The City Lacked Written Policies and Procedures

The City did not have written policies and procedures for obligating NSP I funds in DRGR. It used its policies and procedures for other HUD programs when it obligated NSP I funds in DRGR. Those policies and procedures did not comply with NSP I obligation requirements.

HUD Will Recapture Funds Not Properly Obligated

HUD will recapture any portion of the City's NSP I funds not properly obligated by the September 20, 2010, deadline, and the intended recipients will lose the benefit of the planned activities. If the City does not deobligate the more than \$1.5 million improperly obligated and reobligate the funding properly, HUD will recapture those funds.

HERA and the grant agreement between HUD and the City require the grantee to obligate NSP I funds 18 months from the date the grant agreement was signed by HUD. The grant agreement was signed on March 20, 2009, which means that the City has until September 20, 2010, to obligate the NSP I funds.

Federal Register Volume 73, No. 194, dated Monday, October 6, 2008, states that if any jurisdiction, State, or insular or local area fails to meet the requirement to use its grant within 18 months of receipt of the amounts, HUD will proceed to recapture the unused funds.

Recommendations

We recommend that the Director of the HUD Denver Office of Community Planning and Development require the City to

- 1A. Deobligate any portion of the \$1,535,289 in NSP I funds which was not properly obligated.
- 1B. Develop and implement policies and procedures to ensure proper obligation of NSP I funding.

Finding 2: The City Did Not Post Two Quarterly NSP I Performance Reports When Required

The City did not post two quarterly NSP I performance reports on its official Web site within the 30-day requirement. This delay occurred because the City misunderstood HUD's reporting requirements. As a result, the public did not have access to timely information regarding the spending of the NSP I funds.

Quarterly NSP I Performance Reports Were Not Posted When Required

The City did not post two quarterly NSP I performance reports on its official Web site within the 30-day requirement. It posted the December 31, 2009, quarterly NSP I performance report on May 25, 2010, which was 115 days late. It posted the March 31, 2010, quarterly NSP I performance report on May 27, 2010, which was 27 days late.

Federal Register Volume 73, No. 194, dated Monday, October 6, 2008, and the City's policies and procedures require NSP I performance reports to be posted on the City's official Web site 30 days after the end of the quarter.

The City Misunderstood HUD's Reporting Requirements

The City misunderstood HUD's reporting requirements. It thought the quarterly NSP I reports had to be approved by HUD in DRGR before it could post them to its Web site. As a result of our review, the City posted the two quarterly NSP I performance reports to its official Web site.

The Public Did Not Have Access to Timely Information

The public did not have access to timely information regarding the spending of the NSP I funds. The City was not transparent regarding its use of the NSP I funds as required.

Recommendations

We recommend that the Director of the HUD Denver Office of Community Planning and Development

- 2A. Provide technical assistance to the City regarding HUD's reporting requirements to ensure that the City posts quarterly NSP I performance reports on its official Web site within the 30-day requirement.

SCOPE AND METHODOLOGY

We performed the onsite review work from April through June 2010 at the City's office located at 201 West Colfax Avenue, Denver, CO. Our audit period was March 1, 2009, through March 31, 2010, and was expanded to include the most current data available for obligations.

To accomplish the audit objectives, we reviewed HUD's rules and regulations as well as the City's policies and procedures related to NSP I. We also interviewed HUD's and the City's NSP I staff. In addition, we reviewed the NSP I grant agreement between HUD and the City and the City's audited financial statements from 2008.

We reviewed all four contracts between the City and its developers and subrecipients. We also examined the City's official Web site to determine whether the City posted quarterly NSP I performance reports as required.

We reviewed the City's NSP I obligations recorded during our audit period in DRGR and compared these obligations with the City's internal records. We used grant data maintained by HUD in the DRGR system to determine that the City obligated more than \$6 million while it could only support a little more than \$4.5 million as of July 29, 2010. We subtracted the \$4.5 million of supported obligation from the total of \$6 million obligated in DRGR to determine the funds to be put to better use is approximately \$1.5 million.

We compared the data maintained in HUD's Line of Control Credit System (LOCCS) with the City's internal data on expenditures. We then used the data maintained in the City's computer systems to select a sample of disbursements. We selected and reviewed 13 of the 63 NSP I draws during our audit period. We did not perform a 100 percent selection or a representative selection using statistical or nonstatistical sampling because we wanted to select (1) NSP I draws that had the largest dollar amount and (2) samples from the City's administrative draws and each one of the City's NSP I developers and subrecipients.

For administration activities, we reviewed the City's payroll records, such as timesheets, and journal entries to determine whether administration expenditures were supported. For purchase and rehabilitation activities, we reviewed project files to determine whether they contained the correct documentation such as appraisals, invoices, purchase agreements, and environmental and historical reviews.

We also reviewed project files to determine whether the properties were previously foreclosed upon or abandoned, whether the purchase discount amount was more than 1 percent, and whether appraisals and environmental reviews were completed before the property's closing date. Further, we reviewed project files to determine whether the expenses were NSP I eligible, were adequately documented, and complied with NSP I expenditure requirements.

Finally, we reviewed supporting documentation for two properties sold by the developers to determine whether the properties' buyer received 8 hours of housing counseling and whether the

sales price was less than the sum of the acquisition price combined with rehabilitation costs as required by HUD regulations.

We used LOCCS and DRGR for background information only and did not rely on the data to base our conclusions. We based our conclusions on the source data. We relied on computer-processed data maintained by the City for tracking NSP I activities. We performed sufficient tests of the data, and based on the assessment and testing, we concluded that the data were sufficiently reliable to be used in meeting our objectives.

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

INTERNAL CONTROLS

Internal control is a process adapted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

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

Relevant Internal Controls

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

- Management's controls to ensure that NSP I funds are obligated in accordance with HERA rules and regulations.
- Management's controls to ensure that NSP I funds are reported on the City's official Web site in accordance with HUD rules and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

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

- Controls over obligating funds in the DRGR system (finding 1).
- Controls over posting NSP I quarterly performance reports on the City's Web site (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	\$1,535,289

Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Implementation of our recommendations require the City to deobligate any portion of an estimated \$1.5 million in NSP I funds which were improperly obligated so that those funds can be put to better use on projects that have obligations that can be linked to a specific address and/or household.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



DENVER
THE MILE HIGH CITY

September 10, 2010

Mr. Ronald J. Hosking
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
Region VIII Office of Audit
UMB Plaza – 24th Floor
1670 Broadway
Denver, Colorado 80202-4801

Dear Mr. Hosking:

The City and County of Denver's Denver Office of Economic Development ("the City") is providing response to the Office of Inspector General (we) for the Discussion Draft Audit Report issued on September 2, 2010, in regard to the audit of Denver OED's Neighborhood Stabilization Program 1.

The findings are listed with the corresponding recommendations followed by the City responses:

Finding 1: The City Improperly Obligated More Than \$1.5 Million of Its NSP 1 Funds Before The Funds Were Committed to Specific Properties.

Recommendations: We recommend that the Director of the HUD Denver Office of Community Planning and Development require the City to

1A. Deobligate any portion of the \$1,535,289 in NSP 1 funds which was not properly obligated

1B. Develop and implement policies and procedures to ensure proper obligation of NSP 1 funding.

Response: *The City agrees with the finding. The City has obligated 100% of the funding with supporting documentation. The recent HUD Denver CPD monitoring of the City's NSP program identified that there is no need to de-obligate any amount. The City, working with HUD Denver CPD, has developed procedures for implementation to ensure proper obligation of NSP funding. The finding resulted from the City developing a program and working to meet the program goals, while HUD was still developing guidelines and procedures specific to this program. The City's procedures will be provided to HUD Denver within thirty days of this response.*

Finding 2: The City Did Not Post Two Quarterly NSP 1 Performance Reports When Required.

Comment 1

GROWDENVER
The Office of Economic Development

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Denver, CO 80202
P: 720.913.1999
www.milehigh.com

Ref to OIG Evaluation

Auditee Comments

Comment 2

Recommendation: We recommend that the Director of the HUD Denver Office of Community Planning and Development

2A. Provide technical assistance to the City regarding HUD's reporting requirements to ensure that the City posts quarterly NSP 1 performance reports on its official Web sit within the 30-day requirement.

Response: The City agrees with the finding. The City has now developed procedures for immediate implementation to ensure timely posting of Quarterly NSP 1 Performance Reports on its Web site. The NSP 1 Performance has been reported in a number of manners, including updates to Denver's ARRA Oversight Committee (which includes national, state and local elected officials and their staff, key leaders and stakeholders), updates to the Denver City Council, and responses to media and public requests.

Nevertheless, the City acknowledges the need to report NSP 1 Performance outcomes and status both through the federal reporting systems and our web site.

The City appreciates the opportunity to respond to HUD Office of the Inspector General's draft audit of the City's NSP 1 program. If you have any questions or we can provide any other assistance, please contact me (jeff.romine@Denvergov.org or 720-913-1526) at your earliest convenience.

Respectfully,



Jeff Romine
Interim Director, Business and Housing Services
Denver's Office of Economic Development

OIG Evaluation of Auditee Comments

The City's written response along with its verbal response at the exit conference indicates agreement with the findings and recommendations.

Comment 1 Planned actions on the part of the City should resolve identified issues.

Comment 2 Planned actions on the part of the City should resolve identified issues.