



The City of San Bernardino, CA

Community Development Block Grant Formula Allocation and Recovery Act Programs



Issue Date: April 23, 2013

Audit Report Number: 2013-LA-1004

TO: William Vasquez, Director, Los Angeles HUD Office of Community Planning and Development, 9DD

Dane Narode, Associate General Counsel for Program Enforcement, CACC

///SIGNED///

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region 9, 9DGA

SUBJECT: The City of San Bernardino, CA, Did Not Administer Its Community Development Block Grant and Community Development Block Grant-Recovery Act Programs in Accordance With HUD Rules and Regulations

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the City of San Bernardino's Community Development Block Grant and Community Development Block Grant-Recovery Act programs.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.



April 23, 2013

The City of San Bernardino, CA, Did Not Administer Its Community Development Block Grant and Community Development Block Grant-Recovery Act Programs in Accordance With HUD Rules and Regulations

Highlights

Audit Report 2013-LA-1004

What We Audited and Why

We reviewed the City of San Bernardino's Community Development Block Grant (CDBG) and CDBG-Recovery Act (CDBG-R) programs because the U.S. Department of Housing and Urban Development's (HUD) Los Angeles Office of Community Planning and Development expressed concerns about the City's administration of its CDBG program. Our objective was to determine whether the City administered its CDBG and CDBG-R program funds in accordance with applicable HUD requirements.

What We Recommend

We recommend the Director of HUD's Los Angeles Office of Community Planning and Development require the City to (1) repay \$47,699 in ineligible expenses from non-Federal sources, (2) support more than \$7.1 million in expenses or repay the program, (3) remit \$168,761 in unreported program income, and (4) demonstrate the reasonableness of \$951,548 in Recovery Act funds used in the procurement of two contracts. We also recommend that HUD's Associate Counsel for Program Enforcement pursue civil remedies, civil money penalties, or other administrative action, as appropriate, against the City for intentionally not reporting CDBG program income.

What We Found

The City did not operate in accordance with HUD rules and regulations. It used \$47,699 in CDBG funds for ineligible expenditures and lacked supporting documentation for more than \$7.1 million. The City also did not report \$168,761 in program income and did not adequately support its procurement activities for the \$951,548 in Recovery Act funds it received.

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BACKGROUND AND OBJECTIVE

The City of San Bernardino operates under a hybrid mayor-council-city manager form of government. Each of the seven members of the council is elected by voters within their respective wards. The mayor and council members serve 4-year terms. Under the supervision of the mayor, the city manager is the chief administrative officer. The city manager directs most City departments, other than those governed by separate boards and offices of elected officials. The city manager’s office, in addition to assisting the mayor and council in policy formulation, focuses on special projects. The City also has an elected city attorney, city treasurer, and city clerk.

The City was awarded the following Community Development Block Grant (CDBG) and CDBG-Recovery Act (CDBG-R) funds:

Fiscal year	CDBG	CDBG-R	Total
July 1, 2009, to June 30, 2010	\$3,602,903	\$951,548	\$4,554,451
July 1, 2010, to June 30, 2011	\$3,891,483	Not applicable	\$3,891,483
July 1, 2011, to June 30, 2012	\$3,244,569	Not applicable	\$3,244,569
		Total	\$11,690,503

The City filed an emergency petition for Chapter 9 bankruptcy on August 1, 2012. It will continue to operate and provide essential services to its community while working through its financial problems under the protection of the Chapter 9 bankruptcy code.

The City had been using its Economic Development Agency to administer its CDBG and CDBG-R funds. The Economic Development Agency is equivalent to a redevelopment agency. The governor of California executed a proposal to eliminate all redevelopment agencies statewide on June 29, 2011. Consequently, on January 9, 2012, the City became the successor agency to the Economic Development Agency. As such, the City is now directly responsible for administering the program funds.

HUD’s Los Angeles Office of Community Planning and Development last performed an onsite monitoring review of the City’s CDBG program for the fiscal year ending June 30, 2006. It identified a lack of adequate documentation for the use of CDBG funds under the City’s code enforcement program and that its reimbursement system was inadequate to identify the funding source. In addition, HUD’s review of the City’s consolidated annual performance and evaluation report submissions for the fiscal years ending June 30, 2010, and June 30, 2011, identified discrepancies between the report and information in HUD’s systems, difficulties in timely and accurate accounting for program income and expenditures, and overspending on code enforcement expenditures. As of February 2013, the City had not submitted its report to HUD for the fiscal year ending June 30, 2012, which was due September 30, 2012.

Audit Objective

Our objective was to determine whether the City administered its CDBG and CDBG-R program funds in accordance with HUD rules and regulations. Specifically, we wanted to determine whether program funds were used for eligible purposes and program income was reported in accordance with regulations.

RESULTS OF AUDIT

Finding 1: The City Improperly Used or Lacked Supporting Documentation for Its Use of More Than \$7.16 Million in Program Funds

The City did not comply with Federal regulations when it improperly used or lacked supporting documentation for the use of more than \$7.16 million in CDBG program funds. Specifically, the City used \$47,699 in program funds for ineligible expenses, and it could not support the eligibility of \$7.11 million in program funds. The problems occurred because the City did not have adequate procedures and lacked the capacity to monitor the program to ensure that HUD regulations were followed. As a result, more than \$7.16 million in program funds was not available for decent, affordable housing and other services principally for low- and moderate-income persons.

The City Used CDBG Funds for Ineligible Expenses

The City spent \$47,699 for ineligible expenses (see appendix D). The ineligible expenses included

- \$13,698 for services for ineligible properties, overdraws on program funds, etc.;
- \$14,001 in general government expenses; and
- \$20,000 in additional funding for its subrecipient to overcome another Federal agency fund deficiency.

Ineligible Code Enforcement Expenditures Totaled \$13,698

The City used program funds totaling \$13,698 in ineligible expenditures for the following:

- Overdraws of \$10,003 in program funds. For the fiscal year ending June 30, 2011, the City drew more than \$2.58 million in code compliance expenditures, but accounting records showed expenditures totaled only \$2.57 million, so program funds were overdrawn by \$10,003.
- Overdraws of \$1,845 for May 2011 code compliance expenditures. The City incorrectly calculated the amount it should be reimbursed, charging \$123,885 when the actual amount totaled \$122,040 in expenses.
- Reimbursement of \$1,436 for services performed on ineligible properties that were listed as non-CDBG in the City's automated Go-Enforce system.

- Case number 10-19353¹ (\$535)
- Case number 09-7949 (\$753)
- Case number 09-19667 (\$148)
- Duplicate costs claimed for the same amendment of tax bills for the months of November and December 2010 totaling \$414.

Ineligible Administrative Costs Totaled \$14,001

Contrary to 24 CFR (Code of Federal Regulations) 570.207(a)(2), the City charged an allocation of \$14,001 in ineligible general government cost to the program.

Ineligible Additional Funding of \$20,000 Was Provided to a Subrecipient

The City provided additional funding of \$20,000 to one subrecipient to overcome another Federal agency fund deficiency. The Legal Aid Society already had received \$9,500 from program funds to perform CDBG-related activities. City council records detailed that the subrecipient was “short on cash” and a council member was “hoping they could get \$20,000 from unexpended CDBG funding.” We determined that the Legal Aid Society, Inland Counties Legal Services, Inc., a Federal agency, was reducing its funds. As a result, the city council approved the allocation of \$20,000 to the subrecipient to be issued due to urgent need. However, regulations at 2 CFR Part 225, appendix A, paragraph C.3.c state that any cost allocable to a particular Federal award or cost objective under these regulations may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. In addition, the cash shortage was not urgent as claimed in the city council notes. Records showed that the cuts in funding were signed in February 2012, after the January 5, 2012, general ledger entries for \$20,000. The initial reduction in funds of about \$3,500 was not scheduled to start until April 2012.

The City Lacked Supporting Documentation for Expenditures and Draws

Expenses totaling more than \$7.1 million were unsupported because the City lacked documentation to support the reimbursements (see appendix D). The missing documentation included, among other records, checks, invoices, contracts, and support for allocation methodologies. In some circumstances, there were no records provided for the expenditures. The unsupported expenses included

- More than \$4.8 million in code enforcement expenditures, including but not limited to salaries, supplies, contract services, fleet, government outreach, etc.;
- More than \$1.3 million in administrative costs; and

¹ Case numbers were provided in place of addresses.

- \$942,266 in sample draws without adequate records to support the expenditures.

Unsupported Code Enforcement Expenditures

The code compliance division spent \$4.8 million for unsupported costs. Most of the funds were spent on salaries and benefits for code enforcement officers. The City used various percentages (94, 84, or 40 percent) for their code enforcement salaries without an adequate cost allocation plan or explanation to support how these percentages were determined. The City also charged lump-sum amounts for expense items with no basis or records to show how the amounts were determined. For example, in 2010,² the City charged, among other expenses, information technology costs (\$217,024), worker's compensation benefits (\$179,872), liability charges (\$262,108), and telephone expenses (\$101,640) with no records to support the amount attributed to the CDBG program. Further, the City was inconsistent in charging expenses to the CDBG program. For example, in 2009, it determined that \$115,991 in disallowed expenses should not be reimbursed with CDBG funds. However, in 2010, it retroactively charged 20 percent of the \$115,991 to the CDBG program with no basis or explanation. This practice continued for several months in 2010 and then stopped. Afterward, the percentages fluctuated for each expense charged to the program, and City staff could not explain the amounts charged.

Unsupported Administrative Costs

The City drew down \$1.3 million in unsupported program funds for its administrative costs (refer to appendix D). It did not maintain an adequate cost allocation plan as required by 2CFR Part 225, appendix A, paragraph C.3.d (see appendix C) and used an allocation method based, for the most part, on estimates not supported by formal accounting and other records to support the propriety of the costs assigned to Federal awards. Further, the City was unable to provide an adequate explanation or support for how the percentages were determined. As a result, we determined more than \$1.3 million in administrative costs to be unsupported.

Unsupported Sample Draws

The City drew down \$942,266 in program funds, including \$462,820 in CDBG and \$479,446 in CDBG-R funds, without adequate support (see appendix D). The vouchers submitted were not adequately documented. Specifically, these expenses were not supported by source documents such as invoices. Regulations at 24 CFR 85.20 require that grantees maintain records which adequately identify the source and application of funds. Accounting records must be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records, and contract and subgrant award documents. Contrary to the regulations, the City did not maintain adequate accounting records to support the

² For the fiscal year ending June 30, 2011, the City budgeted \$1.7 million but spent more than \$2.5 million in code compliance division expenditures. It overspent by \$853,863 without HUD's approval or a formal amendment.

draws sampled. As a result, we determined \$942,266 to be unsupported, of which \$479,446 was CDBG-R funds.

The City Lacked Procedures and Capacity To Monitor the Program

The City did not ensure that it followed all HUD rules and regulations because it did not have adequate procedures or the capacity to monitor the program. Before the statewide termination of redevelopment agencies, the City's Economic Development Agency ran the CDBG program with no monitoring from the City. Due to the lack of program monitoring, City staff members were unable to explain actions by the Agency before its termination. In addition, the only procedures related to the CDBG program consisted of a binder called "A Timeline of Monthly Steps and Proposed Schedule." Further, the City explained that it was not working on a new policy and procedures related to CDBG because of its short staffing for the program. There was only one staff member assigned to oversee and report on the program. The inadequate procedures were due to the City's lack of capacity to monitor the program and not sufficiently recognizing the need for developing and maintaining proper controls.

Conclusion

The City used more than \$7.1 million in program funds for ineligible or unsupported expenses. This condition occurred because the City did not follow all of HUD's rules and regulations as it did not have adequate procedures or the capacity to monitor the program. As a result, more than \$7 million in CDBG funds was not available for decent, affordable housing and other services principally for low- and moderate-income persons.

Recommendations

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

- 1A. Repay the CDBG program \$47,699 for ineligible expenses from non-Federal funds.
- 1B. Provide support for \$6,637,341 in unsupported costs or repay the CDBG program from non-Federal funds.
- 1C. Provide support for \$479,446 in unsupported CDBG-R costs or repay the U.S. Treasury from non-Federal funds.

- 1D. Suspend the program and CDBG funding until it can demonstrate that it has procedures and controls in place and capacity to operate its program properly.
- 1E. Establish and implement sufficient internal control policies and procedures to ensure that CDBG program funds are committed and expended in accordance with HUD rules and requirements.

Finding 2: The City Did Not Report Program Income Generated From Program Activities

The City did not report program income generated from its CDBG activities in accordance with Federal regulations. It failed to report \$168,761 in program income earned from CDBG activities. This condition occurred because the did not have any applicable program income policies and procedures. As a result, \$168,761 in CDBG funds was not available for decent, affordable housing and other services principally for low- and moderate-income persons.

Inaccurate Information Was Reported to HUD

The City did not report accurate and timely program income to HUD as required by Federal regulations at 24 CFR 570.504. It reported a total of \$184,836 in program income for fiscal years ending June 30, 2010, and June 30, 2011. Not only did the City erroneously report the amount of program income, the \$184,836 in program income that it reported was inaccurately attributed to

- Code compliance,
- Center for individuals with disabilities, and
- General program administration.

The City had not reported any program income for the fiscal year ending June 30, 2012, because it had not submitted its applicable consolidated annual performance and evaluation report.

The City's neighborhood rehabilitation program revolving loans generated \$176,716 of the program income, and the remaining \$8,120 was generated from demolition costs incurred by the City. This inaccurate reporting misled HUD to believe that the City was reporting program income for its code compliance activity³ when it did not. This condition occurred because the City did not have any applicable program income policies and procedures to ensure its staff to follow appropriate program requirements. As a result, it could not assure HUD that it could appropriately account for its program income for the use of decent, affordable housing and other services for low- and moderate-income persons before using additional program funds.

³ The City's code compliance division received most of the entitlement grant.

Program Income Was Not Reported

The City failed to report \$168,761 in CDBG program income to HUD in accordance with Federal requirements. Regulations at 24 CFR 570.504(a) require that receipts and expenditures of program income be recorded as part of the financial transactions of the grant program. The regulations also require that program income be disbursed for eligible activities before additional cash withdrawals are made from the U.S. Treasury. The City did not report program income for the following activities:

1. Neighborhood Rehabilitation Program Income

The City's repayment of revolving loans generated \$249,731 in program income for fiscal years ending June 30, 2010, June 30, 2011, and June 30, 2012; however, the City reported that its loan program generated only \$176,716. Additionally, the City incorrectly reported program income generated from its revolving loans for those years.

- For the fiscal year ending June 30, 2010, \$430 in income was reported to HUD over the actual program income generated for that year. According to the City, the difference was attributable to the understatement of income to HUD for the fiscal year ending June 30, 2009.
- For the fiscal year ending June 30, 2011, the City reported \$104,848 in program income, an overstatement of \$1,000. The City stated that the overreporting of income was due to a clerical error.
- For the fiscal year ending June 30, 2012, the City had not reported any of its income of \$73,445⁴ generated from its revolving loans.

2. Demolition Program Income

The City expended \$109,467 in CDBG funds for demolition costs and recuperated those funds by either direct payment from the owners of the properties being demolished or through tax liens placed on the properties until the full cost was recaptured. However, the City did not record the receipt of demolitions as CDBG program income in a specified general ledger. Instead, it recorded the income in its general fund account. Overall, the City generated a total of \$182,031 in program income between 2009 and 2011, of which it received \$103,436. However, the City recorded and reported only one receipt to HUD in the amount of \$8,120. As a result, it failed to report the remaining \$95,316 in program income received from the demolition activity. Further, according to the City, the remaining amount, \$78,595⁵ in program income

⁴ The applicable amount for the fiscal year ending June 30, 2012, was \$74,445. However, since the City overreported its program income for the prior year by \$1,000, we netted the amount to \$73,445 (\$74,445-\$1,000).

⁵ \$182,031-\$103,436=\$78,595

earned, had not been received. Once this income is received, the City should report the amount to HUD in accordance to 24 CR 570.504(a).

Refer to table below for a summary of unreported program income.

Summary of unreported program income

Activity	Amount
Neighborhood Rehabilitation Revolving Loan Program	\$73,445
Demolition	\$95,316
Total unreported program income	\$168,761

The unreported program income of \$168,761 was not available for decent, affordable housing and other services principally for low- and moderate-income persons. These conditions occurred because the City did not have program income policies and procedures.

The City Lacked Program Income Procedures

Before the City became the successor agency to the Economic Development Agency,⁶ the Agency administered the CDBG program. Although the City had general procedures regarding program income, they addressed only program income generated from revolving loans. All other income (such as code compliance) generated was reported under the general fund; therefore, any income applicable to the CDBG program would not be identified as such. Economic Development Agency officials explained that they had told the City many times that the CDBG program income must be returned to the CDBG program.

In 2010, the Agency had an independent consultant conduct a CDBG review. The consultant's report, dated January 2010, recommended that the code enforcement program track all repayments of demolition expenses attributable to the CDBG program and deposit the funds into a separate account, not in general funds. As a result, the City established procedures for its code compliance program; specifically, CDBG funded inspections⁷ in November 2010. However, the City did not address procedures regarding demolition expenses or other activities generating program income.

⁶ The Economic Development Agency was eliminated on June 29, 2011.

⁷ The City's CDBG funded inspections produces revenues through fines and penalties. However, 24 CFR 85.25(d) indicates that fines and penalties are not considered program income.

Conclusion

The City did not report \$168,761 in program income to HUD in accordance with Federal requirements. It inaccurately reported program information and failed to report program income to HUD because it did not have procedures and lacked adequate controls. As a result, \$168,761 in program funds was not available for decent, affordable housing and other services for low- and moderate-income persons.

Recommendations

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

- 2A. Remit to its CDBG program from non-Federal funds the \$73,445 in program income that it received for the repayment of revolving loans.
- 2B. Remit to its CDBG program from non-Federal funds the \$95,316 in program income that it received for its demolition activities.
- 2C. Establish and implement additional procedures and controls to ensure that program income is recorded, reported, and expended in accordance with HUD rules and requirements.

We recommend that HUD's Associate Counsel for Program Enforcement

- 2D. Determine legal sufficiency and if legally sufficient, pursue civil remedies (31 U.S.C (United States Code) Section 3801-3812, 3729, or both), civil money penalties (24 CFR 30.35), or other administrative action against the City, its principals, or both for intentionally not reporting revenues generated from its code compliance division as CDBG program income.

Finding 3: The City Did Not Adequately Support Its Procurement Activities for CDBG-R Activities

The City used CDBG-R funds, procured professional services, and awarded contracts without maintaining records to support its procurement activities. This condition occurred because the City did not adequately monitor the Economic Development Agency and relied on the Agency to maintain the records. As a result, it paid at least \$951,548 to contractors without adequate support to show whether the services were performed at a reasonable cost.

The City Did Not Follow Prudent Procurement Practices

Contrary to 24 CFR 85.36(b)(2), the City did not maintain a contract administration system. It was unable to provide documentation showing that bids were received for services obtained for its CDBG-R activities totaling \$951,548, the entire amount of the grant received. Specifically, the funds were used to award contracts for handicap curbs⁸ (\$451,548) and to Speicher Park⁹ (\$500,000). The City did not adequately monitor the Agency. It relied on the Agency to maintain records but did not monitor the Agency to ensure that it did so. The Agency has since been dissolved, and the City is now directly responsible for administering the program. Although the City established purchasing procedures, they did not detail the requirement of maintaining records in accordance with HUD rules and regulations. Overall, the City paid \$951,548 to two vendors for services without adequate support to ensure that services paid for were obtained at low and competitive costs and in accordance with HUD rules and regulations.

At the March 27, 2013, exit conference, the City provided additional procurement records for the two contracts. However, the procurement records were still incomplete and did not demonstrate the reasonableness of the costs charged to the CDBG-R funds.

Conclusion

The City violated HUD procurement requirements and paid \$951,548 without adequate support to ensure that services were obtained at a low and competitive cost. This condition occurred because the City relied on the Agency to maintain its procurement records. Although the payments were made to unrelated third-party vendors, it was necessary for the City to demonstrate the reasonableness of the costs charged to the CDBG-R funds.

⁸ The scope of work included construction for the Americans with Disabilities Act ramps and sidewalks for various locations citywide.

⁹ The scope of work included construction of a skate park, parking lot, basketball court, and community garden and compliance with the Americans with Disabilities Act for all onsite park improvements.

Recommendations

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

- 3A. Demonstrate the reasonableness of the CDBG-R funds (\$472,102)¹⁰ used on the two contracts and require any unsupported or unreasonable amounts to be repaid to the U.S. Treasury.
- 3B. Implement and follow procurement procedures and maintain records and project files and ensure that they are kept in accordance with HUD rules and regulations.

¹⁰ We recommend that the City demonstrate the reasonableness for the entire \$951,548 used for the two contracts. However, we already questioned \$479,446 of this amount under recommendation 1C. To avoid double counting, we listed the difference of \$472,102 as the questioned costs for recommendation 3A.

SCOPE AND METHODOLOGY

We performed our onsite audit work primarily at the City's office, located in San Bernardino, CA, between July 2012 and February 2013. Our audit generally covered the period January 1, 2010, through June 30, 2012. We expanded our scope as necessary.

To accomplish our audit objective, we

- Reviewed applicable HUD regulations, including Public Law 111-5; Notice of Funding Availability Docket No. FR-5309-N-01; 24 CFR Part 570; 24 CFR Part 85; 2 CFR Part 225; Office of Management and Budget (OMB) Circular A-133; HUD Handbook – Playing by the Rules, Guide to National Objective and Eligible Activities for Entitlement Communities; Office of Community Planning and Development Handbook 6509.2; HUD Guidebook – A Guidebook for Grantees on Subrecipient Oversight; HUD CDBG and Recovery Act Facts, Answers, and Questions; HUD policy alerts and notices; and American Recovery and Reinvestment Act of 2009 and OMB Recovery Web sites.
- Reviewed the City's internal policies and procedures.
- Interviewed the City's staff.
- Reviewed the City's accounting records, including general ledgers, invoices, and supporting documentation related to the disbursements selected for review.

We selected a nonrepresentative sample of draws from our audit period¹¹ with the highest expenditures and auditor judgment. The City expended \$12.11 million and \$951,548 in CDBG and CDBG-R funds from fiscal years ending June 30, 2009, to June 30, 2012, respectively. Of that amount, we sampled \$1.27 million in CDBG funds and \$432,102 in CDBG-R funds during the survey phase. In the audit phase, we focused on code enforcement expenditures (\$4.87 million), administrative costs (\$1.4 million), program income, and sampled draws. For our procurement review, we selected the highest expenditures, which also happened to be funded under the Recovery Act. The only computer data system we relied on during the audit was the City's Go-Enforce system, which we used to determine whether code compliance properties were designated as CDBG. We confirmed examples to source documents to determine that the information was reliable enough for audit purposes.

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 objective(s). We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

¹¹ Although our audit period started January 1, 2010, there were instances in which we reviewed expenditures from the fiscal year ending June 30, 2010, because the City did not request these expenditures to be reimbursed until the fiscal year ending June 30, 2011.

INTERNAL CONTROLS

Internal control is a process adopted 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 objective:

- Policies and procedures that management has implemented to ensure that program funds are expended in accordance with HUD rules and regulations.
- Policies, procedures, and controls that management has implemented to ensure that program income generated is reported to HUD in accordance with rules and regulations.

We assessed the relevant controls identified above.

A deficiency in internal controls 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:

- The City lacked adequate controls over its CDBG and CDBG-R programs to ensure that program funds were expended in compliance with HUD rules and regulations (see findings 1 and 3).

- The City lacked sufficient procedures to ensure that program income generated was reported to HUD (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1A	\$47,699	
1B		\$6,637,341
1C		\$479,446
2A	\$73,445	
2B	\$95,316	
3A		\$472,102 ¹²
Total	\$216,460	\$7,588,889

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 the audit. Unsupported costs require the decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve legal interpretation or clarification of departmental policies and procedures.

¹² In finding 1 (recommendation 1C), we determined \$479,446 of the \$951,548 in CDBG-R funds to be unsupported costs. To avoid double counting, we listed the difference of \$472,102 as the questioned costs for recommendation 3A.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2

Monday, April 8, 2013

Tanya E. Schulze
Regional Inspector General for Audit
Office of Audit (Region 9)
611 West 6th Street, Suite 1160
Los Angeles, CA 90017

Dear Ms. Schulze,

The City of San Bernardino (CSB) received the revised draft audit report and cover letter dated March 28, 2013. That letter requested formal conclusions and comments to be submitted by April 8, 2013. Upon receipt of the report, the city hired a consultant with experience working with both the Department of Housing and Urban Development (HUD) and the Office of Inspector General (OIG) in Los Angeles, *Name Redacted*.¹

The City of San Bernardino disputes the OIG findings that it has unsupported costs as set forth in Finding 1. The documentation is available, but needs to be compiled in a format which will satisfy the OIG that all funds were used appropriately to provide Code Enforcement for Community Development Block Grant (CDBG) properties. The City is requesting approval of the following allocation methodology to be applied to verifiable, documented Code Enforcement Department costs to determine legitimate, eligible expenses related to CDBG properties.

Methodology

The OIG auditors utilized the City's "Go-Enforcement" system in a limited manner to determine whether code compliance properties were designated as CDBG. However, that system also contains information to support all enforcement actions for each property which are relevant to the direct payroll allocation of staff members. The City is proposing to provide additional data from Go Enforce to support the costs set forth in Finding 1. Allocation calculations will be

¹ *Name Redacted* has a J.D. and a B.B.A. and is licensed in her home state as a member of the Wisconsin State Bar and Department of Regulation and Licensing as a C.P.A. In California she provides business consulting and accounting services. She dealt with the Department of HUD administering funds for over nine years as Chief Financial Officer of a Los Angeles nonprofit and a consultant on a similar HUD/OIG audit for a San Bernardino nonprofit.

*Names redacted for privacy reasons

clearly defined, are readily accessible, detailed as to person, date, time, and activity and can be reproduced by auditors.

Payroll Allocation Methodology:

Inspection Staff:

Comment 2

Go-Enforce reports can be structured by Inspector, by dates, to list all or specific activities, by property, all or CDBG only. We will identify how many activities within a monthly range each inspector had for CDBG properties divided by the number for all properties visited within that period to determine the allocation percentage to apply to the salary, taxes and fringe benefits. Other available time documentation includes individual Inspector time “Tracking Forms”² manually prepared by inspectors daily which identifies property locations visited, time there, and whether it was CDBG or Non-CDBG. The methods overlap depending upon the utilization of the Go-Enforce for a specific period within the entire audit period. Where available, we will use the Go-Enforce as the more accurate, inclusive and verifiable documentation to readily differentiate between the property locations for allocation purposes. Tracking forms will be used for employees that are no longer working for the City.

Administrative Personnel in the Code Enforcement division:

Administrative personnel primarily spend their time on documentation for citations, fees, penalties, notices of default, notices of hearing, hearings for liens, etc. This information is also available in Go-Enforce. Creating reports as the time period, the Go-Enforce system identifies activities, (Warrants, Hearings, Administration and Notices) for CDBG properties divided by those same activities for all properties. That percentage will be utilized to allocate Administrative Staff payroll expenses.

Supervisory Staff:

For Administrative supervisory staff, the same allocation percentage calculated for the Administrative staff will be used. For Inspection Supervisory staff, the percentage of total CDBG activities per Go-Enforce will be divided by all similar actions instead of being employee specific or averaging the staff percentage.

Payroll Allocation Example

November 2010

Comment 2

We arbitrarily chose an individual month to illustrate the allocation process. For November, 2010, CSB allocated 100% of the payroll expenses for specific individuals within the department. Instead, we propose to allocate all staff who work on CDBG properties based on the above allocation percentages. Staff assigned to Commercial properties will be excluded. All others providing direct services (Inspectors) can be allocated individually. Using the Go-Enforce method confirms that staff provided services to CDBG properties in excess of the amount originally claimed for the period.³

² Sample of Daily Tracking Form is attached.

³ See attached example.

*Attachments available upon request

Comment 2

Other Expenses:

Office (administrative) expenses will be allocated in the same manner as the Administrative staff, i.e. Monthly Hearing Agenda percentage of CDBG cases, including supplies, postage, printing, copier.

Occupancy:

Office occupancy expenses for (utilities, insurance, repairs, cleaning) will be calculated a little differently. The Code Enforcement Department also inspects properties for Weed abatement. There are 800 such properties, inspected twice annually. Accordingly, the occupancy allocation would be based on CDBG activities divided by all the total of all G-Enforce activities plus 1600 weed abatement inspections.

Fleet Expenses:

Fleet expenses, including vehicles, small tools and equipment, gas, maintenance, and insurance will be allocated in the same manner as the Inspection Supervisory Staff.

Comment 3

Upon approval of the direct payroll costs reconciliation procedures and indirect cost methodology, the City requests that the OIG select sample periods to confirm that all the documentation and information is available for reconciliation and allow sufficient time for the city to demonstrate same. Alternatively, specifically for the payroll, if the OIG requires recalculation for the entire period, CSB requests that the allocation be made by individual staff members on an annual, rather than monthly basis in order to expedite the process.

Comment 3

The City requests that the final audit report be delayed until the above allocation substantiation can be completed. Please contact Brandon Mims, Deputy Director of Housing, if you have any questions at (909) 384-5122.

Sincerely,

Allen Parker

OIG Evaluation of Auditee Comments

- Comment 1** The City disputes the unsupported costs; however, it has not provided the documentation to support the amounts in question. The City was provided with ample opportunity to produce documentation during the course of the audit. The City will be able to work with HUD to address the implementation of an acceptable allocation methodology as part of the audit resolution process for recommendation 1D.
- Comment 2** The OIG gave the City several opportunities to provide the records during the course of the audit. The City will have further opportunity to provide applicable supporting documentation to HUD as part of the audit resolution process for recommendations 1B and 1C.
- Comment 3** The OIG gave the City sufficient opportunity to provide the supporting records in question costs during the course of our audit, from July 2012 through February 2013. As a result, we are not giving an extension to the City. The City can work with HUD to resolve the questioned costs as part of the audit resolution process.

Appendix C

CRITERIA

24 CFR 570.200, General policies

24 CFR 570.200(a)(2), *Compliance with national objectives*. Grant recipients under the Entitlement and HUD-administered under the Entitlement and HUD-administered Small Cities programs must certify that their projected use of funds has been developed as to give maximum feasible priority to activities which will carry out one of the national objectives of benefit to low and moderate income families or aid in the prevention or elimination of slums or blight.

24 CFR 570.200(a)(5), *Cost Principles*. Costs incurred, whether charged on a direct or an indirect basis, must be in conformance with OMB Circulars A-87, “Cost Principles for State, Local and Indian Tribal Governments.”

24 CFR 570.206, Program administrative costs. Payment of reasonable administrative costs and carrying charges related to the planning and execution of community development activities assisted in whole or in part with funds provided this part and, where applicable, housing activities (described in paragraph (g) of this section) covered in the recipients housing assistance plan. This does not include staff and overhead costs directly related to carrying out activities eligible under section 570.201 through 570.204, since those costs are eligible as part of such activities.

24 CFR 570.206(a)(1), *General management, oversight and coordination*. Reasonable costs of overall program management, coordination, monitoring, and evaluation. Such costs include, but are not necessarily limited to, necessary expenditures for the following: Salaries, wages, and related costs of the recipient’s staff, the staff of local public agencies, or other staff engaged in program administration. In charging costs to this category the recipient may either include the entire salary, wages, and related costs allocable to the program of each person whose *primary* responsibilities with regard to the program involve program administration assignments, or the pro rata share of the salary, wages, and related costs of each person whose job includes *any* program administration assignments...

24 CFR 570.207, Ineligible activities

24 CFR Part 570.207(a)(2), *General government expenses*. Except as otherwise specifically authorized in this subpart or under OMB Circular A-87, expenses required to carry out the regular responsibilities of the unit of general local government are not eligible for assistance under this part.

24 CFR 570.427, Program amendments

24 CFR 570.427(a), *HUD approval of certain program amendments*. Grantees shall request prior HUD approval for all program amendments involving new activities or alteration of existing activities that will significantly change the scope, location, or objectives of the approved activities or beneficiaries.

24 CFR 570.501, Responsibility for grant administration

24 CFR 570.501(b). The recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. The use of designated public agencies, subrecipients, or contractors does not relieve the recipient of this responsibility. The recipient is also responsible for determining the adequacy of performance under subrecipient agreements and procurement contracts, and for taking appropriate action when performance problems arise, such as the actions described in section 570.910.

24 CFR 570.502, Applicability of uniform administrative requirements

24 CFR 570.502(a). Recipients and subrecipients that are governmental entities (including public agencies) shall comply with the requirements and standards of OMB Circular No. A-87, “Cost Principles for State, Local, and Indian Tribal Governments.”

24 CFR 570.506, Records to be maintained. Each recipient shall establish and maintain sufficient records to enable the [HUD] Secretary to determine whether the recipient has met the requirements of this part.

24 CFR 570.905, Review of continuing capacity to carry out CDBG funded activities in a timely manner. If HUD determines that the recipient has not carried out its CDBG activities and certifications in accordance with the requirements and criteria described in section 570.901 or 570.902, HUD will undertake a further review to determine whether or not the recipient has continuing capacity to carry out its activities in a timely manner. In making the determinations, the Department will consider the nature and extent of the recipient’s performance deficiencies, types of corrective actions the recipient has undertaken and the success or likely success of such actions.

2 CFR Part 225, appendix A, paragraph C.3.d, states, “Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Appendices C, D, and E to this part.” According to Appendix E, State and Local Indirect Cost Rate Proposals, paragraph (B)(2), “...‘Indirect cost rate’ is a device for determining in a reasonable manner the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect costs to a direct cost base.” Further, paragraph (D)(1)(a) of appendix E states, “All department or agencies of the governmental unit desiring to claim indirect costs under Federal awards must prepare an indirect cost rate proposal and related document to support those costs.” In addition, paragraph (D)(2)(a) specifies, “Documentation of proposals. The following shall be included with each indirect cost proposal:

The rates proposed, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the financial data...”

2 CFR 225, Appendix A, paragraph C.3.c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in 2 CFR part 225 may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.

24 CFR Part 570

24 CFR 570.500(a). *Program income* means gross income received by the recipient or a subrecipient directly generated from the use of CDBG funds, except as provided in paragraph (a)(4) of this section.

24 CFR 570.500(a)(1)(x). Funds collected through special assessments made against properties owned and occupied by households *not* of low and moderate income, where the assessments are used to recover all or part of the CDBG portion of a public improvement.

24 CFR 570.503(b)(3), *Program income*. The agreement shall include the program income requirements set forth in § 570.504(c). The agreement shall also specify that, at the end of the program year, the grantee may require remittance of all or part of any program income balances (including investments thereof) held by the subrecipient (except those needed for immediate cash needs, cash balances of a revolving loan fund, cash balances from a lump sum drawdown, or cash or investments held for section 108 security needs).

24 CFR 570.504(a), *Recording program income*. The receipt and expenditure of program income as defined in § 570.500(a) shall be recorded as part of the financial transactions of the grant program.

(b) *Disposition of program income received by recipients.*

(1) Program income received before grant closeout may be retained by the recipient if the income is treated as additional CDBG funds subject to all applicable requirements governing the use of CDBG funds.

(2) If the recipient chooses to retain program income, that program income shall be disposed of as follows:

(i) Program income in the form of repayments to, or interest earned on, a revolving fund as defined in section 570.500(b) shall be substantially disbursed from the funds before additional cash withdrawals are made from the U.S. Treasury for the same activity.

(ii) Substantially all other program income shall be disbursed for eligible activities before additional cash withdrawals are made from the U.S. Treasury.

(iii) At the end of each program year, the aggregate amount of program income cash balances and any investment thereof (except those needed for immediate cash needs, cash balances of a revolving loan fund, cash balances from a lump-sum drawdown, or cash or investments held for section 108 loan guarantee security needs) that, as of the last day of the program year, exceeds one-twelfth of the most recent grant made pursuant to section 570.304 shall be remitted to HUD as soon as practicable thereafter, to be placed in the recipient's line of credit.

24 CFR 570.504(b)(3). Program income on hand at the time of closeout shall continue to be subject to the eligibility requirements in subpart C and all other applicable provisions of this part until it is expended.

24 CFR 85.25(d) Governmental revenues. Taxes, special assessments, levies, fines, and other such revenues raised by a grantee or subgrantee are not program income unless the revenues are specifically identified in the grant agreement or Federal agency regulations as program income.

24 CFR 85.36(b), Procurement standards

(1) Grantees and subgrantees will use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards identified in this section.

(2) Grantees and subgrantees will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders.

Appendix D

SUMMARY OF QUESTIONED COSTS

Code enforcement expenditures, administrative costs, sample draws¹³

Code enforcement expenditures								
Description	Unsupported amount				Ineligible amount			
	FYE* June 30, 2010	FYE June 30, 2011	FYE June 30, 2012	Total	FYE June 30, 2010	FYE June 30, 2011	FYE June 30, 2012	Total
Salaries & benefits	\$1,183,855	\$1,641,609	\$1,070,000	\$3,895,464	n/a	n/a	n/a	\$0
Supplies	\$4,439	\$36,447		\$40,886	n/a	n/a	n/a	\$0
Tools & equipment	\$686			\$686	n/a	n/a	n/a	\$0
Printing	\$1,907	\$417		\$2,324	n/a	n/a	n/a	\$0
Postage	\$12,350			\$12,350	n/a	n/a	n/a	\$0
Copy machine & copier	\$1,057	\$3,320		\$4,378	n/a	n/a	n/a	\$0
Other operating expenses	\$651			\$651	n/a	n/a	n/a	\$0
Garage	\$5,750			\$5,750	n/a	n/a	n/a	\$0
IT** charges in house	\$5,000	\$217,024		\$222,024	n/a	n/a	n/a	\$0
Telephone	\$2,500	\$101,640		\$104,140	n/a	n/a	n/a	\$0
Communications	\$2,475			\$2,475	n/a	n/a	n/a	\$0
Fleet & fuel	\$7,400	\$30,073		\$37,473	n/a	n/a	n/a	\$0
Worker's compensation		\$179,872		\$179,872	n/a	n/a	n/a	\$0
Liability charges		\$262,108		\$262,108	n/a	n/a	n/a	\$0
Membership dues		\$2,175		\$2,175	n/a	n/a	n/a	\$0
Medical supplies		\$591		\$591	n/a	n/a	n/a	\$0
Contract services, county assessor, medical supplies, county auditor, lock services, government outreach, county clerk, etc.		\$41,609		\$41,609	n/a	\$1,850	n/a	\$1,850
20 % of expense items		\$32,746		\$32,746	n/a	n/a	n/a	\$0
Subtotal code enforcement expenditures	\$1,228,070	\$2,549,632	\$1,070,000	\$4,847,702	\$0	\$1,850	\$0	\$1,850

¹³ The schedule is a summary of the questioned costs identified during the audit. We provided a detailed itemized listing of questioned costs with the audit report to the City and to HUD.

Administrative costs								
Description	Unsupported amount				Ineligible amount			
	FYE June 30, 2010	FYE June 30, 2011	FYE June 30, 2012	Total	FYE June 30, 2010	FYE June 30, 2011	FYE June 30, 2012	Total
Administrative costs	\$120,000	\$764,299	\$442,520	\$1,326,819	n/a	\$14,001	n/a	\$14,001
Subtotal administrative costs	\$120,000	\$764,299	\$442,520	\$1,326,819	\$0	\$14,001	\$0	\$14,001
Sample draws								
Description	Unsupported amount		Total	Ineligible amount		Total		
Legal Aid Society	\$1,265		\$1,265	n/a		\$0		
Fraze	\$1,722		\$1,722	n/a		\$0		
Children's Fund	\$2,500		\$2,500	n/a		\$0		
Al-Shifa Clinic	\$3,052		\$3,052	n/a		\$0		
St. John's Community	\$1,250		\$1,250	n/a		\$0		
Youth Action Project	\$1,416		\$1,416	n/a		\$0		
Inland AIDS Project	\$1,076		\$1,076	n/a		\$0		
Community Development Department, City of San Bernardino	\$100,000		\$100,000	n/a		\$0		
Senior Services Program	\$81,313		\$81,313	n/a		\$0		
CAL Theatre Phase II	\$28,102		\$28,102	n/a		\$0		
Inland Fair Housing	\$48,785		\$48,785	n/a		\$0		
Eastside Skate Park at Speicher Park ADA Improvement (CDBG-R)	\$379,807		\$379,807	n/a		\$0		
Sun Trust Leasing, Inc.	\$192,339		\$192,339	n/a		\$0		
Handicap curbs and ramps (CDBG-R)	\$99,639		\$99,639	n/a		\$0		
Subtotal sample draws	\$942,266		\$942,266	\$0		\$0		
Other								
Description	Unsupported amount		Total	Ineligible amount		Total		
Additional funding for Legal Aid Society (\$20,000)	n/a		\$0	\$20,000		\$20,000		

Overdrew for FYE June 30, 2011. Drew \$2,581,509 when expenditures totaled only \$2,571,506	n/a		\$10,003	\$10,003
Overdrew for May 2011. The City added incorrectly, and records revealed only \$122,040, not \$123,885	n/a	\$0	\$1,845	\$1,845
Subtotal other	\$0	\$0	\$31,848	\$31,848
Totals				
	Total unsupported (code enforcement, administrative, sample draws, and other questioned costs)	\$7,116,787	Total ineligible (code enforcement, administrative, sample draws, and other questioned costs)	\$47,699

* FYE = fiscal year ending

** IT = information technology