



City of Phoenix

**Mission Statement**

To improve the quality of life in Phoenix through efficient delivery of outstanding public services.

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**Project Number**

1230053

This report can be made available in alternate format upon request.

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## Neighborhood Services Department Community Development Block Grants

June 23, 2023

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### ***Report Highlights***

**Timeliness of Distributions**

*The Neighborhood Services Department currently complies with federal requirements related to timeliness of grant distributions. However, it was not compliant in the prior two fiscal years.*

**Housing Rehabilitation Program**

*The program participants we tested met eligibility requirements. In addition, the program expenditures we tested were approved, properly supported, and allowable under grant guidelines.*

**Agency Eligibility and Files**

*The Neighborhood Services Department provides grants to local non-profit agencies. The agencies we selected for review met federal eligibility requirements. However, some agency files were missing required documentation.*

**Reimbursement Requests**

*We found that requests for federal reimbursement matched the City's financial system information. However, system limitations made it difficult to reconcile individual transactions between the two systems.*

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## **Executive Summary**

### **Purpose**

We reviewed the Neighborhood Services Department (NSD) processes to ensure its administration, monitoring, and reporting on Community Development Block Grants (CDBG) entitlements complied with federal requirements.

### **Background**

The Department of Housing and Urban Development (HUD), under Title I of the Housing and Community Development Act of 1974, authorized the CDBG program. CDBG-funded activities must address one of the following three national objectives: 1) benefit low to moderate-income persons, 2) aid in the prevention or elimination of slums and blight, or 3) meet an urgent community development need. Title 24 of the Code of Federal Regulation (*CFR*) *Part* §570 provides guidance on the CDBG program.

NSD oversees the administration, monitoring, and fiscal reporting of the City's CDBG entitlements. Included in NSD's CDBG projects is the Owner-Occupied Housing Rehabilitation (OOHR) program. OOHR funds home repairs for low to moderate-income families to correct safety and health concerns. In addition, NSD provides CDBG funds to local non-profit agencies to address CDBG national objectives.

Since Fiscal Year (FY) 2019, NSD has received \$65.6M in CDBG & CDBG CARES Act grant funds; as of FY23, \$28.6M remained available for disbursement from prior and current fund years.

#### **CDBG Grant Awards**



**In FY23, \$28.6M in CDBG funds were available for disbursement.**

To evaluate NSD's compliance with the CDBG requirements, we reviewed its timely-use ratios and reporting, subrecipient eligibility and monitoring, and drawdown processing. Transactions we reviewed were found within the City's financial system (SAP), and HUD's Integrated Disbursement and Information System (IDIS).

## Results in Brief

**The Neighborhood Services Department currently complies with federal requirements related to timeliness of grant distributions. However, it was not compliant in the prior two fiscal years.**

To demonstrate the efficient use of grant funds, HUD grantees are required to have a ratio of 1.5 or less of awarded CDBG funds not disbursed within 60 days of the end of the fund year. Since FY19, NSD has failed to meet this timely-use ratio. In FY20 and FY21, HUD provided grantees with waivers due to the pandemic. NSD received its first formal violation in FY22. The department adopted an aggressive workout plan; and, as of May 1, 2023, met the timeliness distribution requirement with a score of 1.49.

**The program participants we tested met eligibility requirements. In addition, the program expenditures we tested were approved, properly supported, and allowable under grant guidelines.**

We tested a sample of ten files against federal and NSD internal monitoring criteria to ensure OOH program expenditures were approved, supported, and allowable under CDBG guidelines. No exceptions were found.

**The Neighborhood Services Department provides grants to local non-profit agencies. The agencies we selected for review met federal eligibility requirements. However, some agency files were missing required documentation.**

We selected seven agencies and tested their files for compliance with federal and NSD eligibility guidelines. Results showed that all of the agencies met the federal requirement for receiving CDBG funds. However, only some of the files selected had adequate documentation to support payment request. NSD staff researched these files and provided all additional documents.

**We found that requests for federal reimbursement matched the City's financial system information. However, system limitations made it difficult to reconcile individual transactions between the two systems.**

We selected 17 invoices for agency payments and tested them for correct posting in SAP. We found no exceptions. Further, we correlated payments in SAP to NSD reports. However, system limitations make it difficult to track specific transactions. NSD staff reported that they do not have a grants management system that would simplify a reconciliation between the federal and City systems.

## **Department Responses to Recommendations**

<b>Rec. 2.1:</b> Formalize the change order policy for the OOHR program.	
<b>Response:</b> NSD's draft change order policy for the OOHR program was shared as a part of the audit. NSD will continue its research efforts on best practices and finalize the change order policy.	<b><u>Target Date:</u></b> August 31, 2023
<b>Rec. 2.2:</b> Evaluate the OOHR program pre-bid inspection process to ensure major repairs are being included in the project scope and contractor proposals.	
<b>Response:</b> NSD will identify comparable cities that administer similar programs and compare their practices with City and Grantor regulations to evaluate and potentially modify Housing Rehabilitation program procedures.	<b><u>Target Date:</u></b> January 31, 2024
<b>Explanation, Target Date &gt; 90 Days:</b> May to October are peak program months. Due to capacity, staff will be able to allocate time to this research effort as the peak season tapers (September/October 2023).	
<b>Rec. 3.1:</b> Review active subrecipient files for missing documentation and update as needed.	
<b>Response:</b> NSD's Grants Compliance Section has implemented a desk file review process and will complete a review of all active CDBG Public Services, Public Facility and Enhancement and Infrastructure projects for missing documentation and update their files as needed.	<b><u>Target Date:</u></b> September 19, 2023
<b>Rec. 4.1:</b> Evaluate the need for a grants management system, and/or work with Finance Business Enterprise Division to determine if there is a way to identify the IDIS voucher number(s) in SAP for the CDBG transactions.	
<b>Response:</b> NSD will meet with the Finance Department to discuss and explore options to incorporate IDIS voucher number(s) in SAP. Additionally, NSD will discuss with ITS solutions to either contract with a vendor or what resources are needed to build a grants management system in-house.	<b><u>Target Date:</u></b> September 19, 2023

# **1 – Timeliness of Distributions and Reporting**

## **Background**

HUD issued *CFR Part §570.902 Performance Reviews* to ensure that grant funds are spent in a timely manner. The code requires that grantees have 1.5 times or less of annual grant monies remaining in their Line of Credit 60 days before the end of the program year. Grantees have seven years to exhaust funds from preceding years.

*CFR Subpart D 200.328 and Part §91.15 Submission Dates* outline the program reports and submission requirements. Specifically, CDBG grant recipients shall provide the following:

- 1) Action Plan and Certifications;
- 2) Consolidated Annual Performance and Evaluation Report;
- 3) Consolidated Plan; and,
- 4) Housing, Homeless Needs Assessment, and Strategic Plan.

We interviewed NSD grant staff and reviewed internal grant reporting processes. We obtained NSD's timely-use ratios and compared them to HUD's required performance guidelines over the last five years. In addition, we identified the required CDBG reports and obtained NSD's submissions for the past three years to verify compliance with all reporting requirements.

## **Results**

***The Neighborhood Services Department currently complies with federal requirements related to timeliness of grant distributions. However, it was not compliant in the prior two fiscal years.***

We reviewed NSD's timely-use ratio for the past five years to determine if it met the 1.5 or less standard. We found that since FY19, the Department failed to meet the timely spend-down standards outlined by HUD. In FY19, NSD was .07 higher than the ratio requirement; NSD was not held noncompliant for that grant year.

Grantees follow a two-step process to resolve any violations. Upon a first violation, HUD sends a warning letter to the grantee and requests a workout plan detailing how the grantee will resolve the violation. If a second violation occurs, HUD invites grantees to an informal consultation at their headquarters where recipients must demonstrate how their lack of timeliness was due to circumstances beyond their control. If a third violation occurs, the grantee may have their annual award reduced by the amount that exceeds the standard.

### CDBG Timely-Use Ratios

Fiscal Year	Timely Ratio	Notes
2019	1.57	Pass
2020	1.85	Waiver
2021	1.96	Waiver
2022	2.54	Fail
2023	1.49	Pass

**NSD's timely-use ratio increased for the past four years; however, it was complaint in FY23.**

In FY20, HUD suspended its adherence to the timeliness guidelines due to the exceptional circumstances brought about by the pandemic. However, on September 30, 2021, HUD re-instated its guidelines for grantees failing to meet the timely-use ratio with new stipulations that considered the grantee status as of FY19, but not FY20 or FY21.

In FY22, NSD's ratio was above the specified guideline at 2.54. NSD received its first violation for its spend-down ratio that year. If they failed in FY23, the Department was in danger of receiving a second violation and having to attend the meeting with HUD regarding its performance. NSD staff reported that in FY22, supply chain issues and labor shortages were major constraints to grant spending which is why they were so far over the standard.

NSD staff advised that they had created an aggressive spending plan to close out all the remaining FY16 funds (\$250,000) and allocate \$15M to \$17M to CDBG-compliant Capital Improvement Projects before FY23 year-end. On May 1, 2023, the Department confirmed that they met the FY23 timely-use ratio with a final score of 1.49. The Department is also working to expend nearly \$673,268 from FY17 entitlements.

#### **NSD was compliant with CDBG reporting guidelines.**

We reviewed NSD's CDBG reports for the past three fiscal years to determine compliance with HUD reporting guidelines. We evaluated the following four required reports:

- **Annual Action Plan and the Certifications** – Identifies program goals and strategies to be achieved over a single fiscal year. In addition, NSD completes required annual program certifications. The plan and certifications must be submitted 45 days before the beginning of each program year.
- **Consolidated Annual Performance and Evaluation Report (CAPER)** – Outlines NSD’s annual accomplishments in meeting its strategic goals and objectives outlined in the Consolidated Plan and summarizes progress made towards the goals identified in the Annual Action Plan. This report is due to HUD 90 days after the end of the reporting period.
- **Consolidated Plan** – Identifies NSD’s program goals and strategies to be achieved over four fiscal years and is required to be provided at least once every five years.
- **Housing and Homeless Needs Assessment, Market Analysis, and Strategic Plan** – Outlines NSD’s plan to meet housing and homeless needs specific to the City’s demographics. NSD must update the plan at least once every five years or as such time agreed upon by HUD and the jurisdiction to facilitate orderly program management.

We obtained some of these reports from NSD’s website and others were provided by NSD staff. In addition, we confirmed with HUD that NSD was generally compliant with their reporting requirements.

### CDBG Reporting Requirements

Report	Frequency	2020	2021	2022
Action Plan/Certifications	Annually	✓	✓	✓
Consolidated Annual Performance and Evaluation Report	Annually	✓	✓	✓
Consolidated Plan	5 years	✓	→	→
Housing, Homeless Needs Assessment and Strategic Plan	5 years	✓	→	→

**NSD has met its reporting requirements for the past three years.**

Our review of FY20 through FY22 CDBG reports, found that NSD met all of HUD's reporting requirements.

## **Recommendations**

None



## **2 –Housing Rehabilitation Program**

### **Background**

The Owner-Occupied Housing Rehabilitation (OOHR) program uses CDBG funds to create viable communities for eligible low to moderate-income neighborhoods. This is accomplished by providing emergency home repairs that address hazards. The assistance is often in the form of zero percent, forgivable loans that are secured by a lien on the property.

The OOHR program requires that the:

- Applicant's income is less than 80% of Area Median Income;
- Property is in Phoenix;
- Property has been the applicant's primary residence for at least 12 months before application; and,
- Property taxes are current.

*CFR Part §570.501 Responsibility for Grant Administration*, indicates that the recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. *CFR Part § 200.329 Monitoring and Reporting Program Performance*, states that the non-federal entity is responsible for overseeing the operations of the federal award-supported activities. The non-federal entity must monitor its activities under national awards to ensure compliance with applicable federal requirements and achievement of performance expectations.

*NSD Policy 07-06 Monitoring Standards* states that all construction work completed be inspected/approved by a Housing Rehabilitation Specialist and labor standards staff. Contractors for the OOHR program are selected by a bid process and must accept payment on a reimbursement basis contingent upon their submittal of supporting source documents. NSD staff checks all contractor invoices for accuracy, allowability, and reasonableness before processing reimbursements.

We interviewed NSD staff regarding internal processes for the OOHR program and obtained written procedures. We tested a sample of OOHR program recipients and transactions to determine compliance with eligibility requirements. In addition, we reviewed NSD's monitoring processes and tested files to determine if the home repairs and improvements were appropriately reviewed and approved.

### **Results**

**We confirmed that OOHR program participants met the program eligibility requirements, and that NSD obtained and maintained required documentation.**

We selected ten homeowners in the OOHR program who received a total of \$477,025 in home improvements and repairs. We tested the files on 13 criteria to ensure

compliance with HUD eligibility and documentation requirements. Eligibility in the OOHR program is based on home ownership and a total household income threshold, which is 80% of the Area Median Income (AMI) for the year of application. All the tested applicants met the AMI income requirement. In addition, all the houses were in the City, were the applicant's primary residence, and had clear titles. HUD requires that applicants complete certain authorizations and acknowledgments.

### OOHR Program Applicant File Testing

Required Documentation	Pass
Authorization for Release of Information & Privacy Act Notice	100%
Affidavit of Lawful Presence Form	100%
Conflict of Interest Acknowledgment	100%
Copies of source documents and/or written verifications	100%
Family Composition form	100%

**All the tested files had the required notices, acknowledgments, and verifications.**

**Tested program expenditures were approved, adequately supported, and allowable.**

We tested a sample of ten files against federal and NSD internal monitoring criteria to ensure OOHR program expenditures were approved, properly supported, and allowable under CDBG guidelines. Our results found no exceptions; all the files passed for invoice recalculation, payment control documentation, approved contracts, deeds of trust, lien waiver releases, signed payment approval for invoices over \$10k, final inspections, and requests for payment documents on file with appropriate signatures.

**90% of reviewed OOHR program projects had change orders which increased project costs. However, all the change orders were assessed for cost reasonableness and approved by NSD management.**

A Housing Rehabilitation Specialist performs an initial review of the OOHR program home and develops the scope of work for each project. Contractors can submit change

orders for necessary repairs that were not captured in the original scope of work. We found that of the ten OOHR program projects reviewed, nine (90%) had change orders that resulted in an increase from the initial contract bid amount. NSD staff explained that the homes that are accepted into the OOHR program are often older and have deferred maintenance issues. Therefore, wiring, plumbing, and foundation issues may not be discovered until construction begins.

### OOHR Program Change Orders



**There was a \$21,517 average increase between original bid prices and final charges on the ten tested OOHR program files.**

NSD has a draft of procedures that require staff and construction experts to review requested change orders for cost reasonableness. The process requires that the Rehabilitation Specialist initiate all change orders. In addition, Revitalization Division Deputy Directors will review and approve any change order if its total is equal to or greater than 25% of the original cost of the project. Change orders are then submitted for a cost reasonableness review by an outside vendor if the total sum of a change order is more than or equal to \$5,000, or if additional costs are more than 20% of the original contract value. The vendor evaluates the change orders to ensure the bids fall within 5% or less of industry standards.

We tested the change orders to determine if they were appropriately reviewed and approved by NSD staff and/or contracted vendors for cost reasonableness. In addition, we tested to ensure that the cost reasonableness confirmed that the requested change order was 5% or less of industry standards. Of the nine OOHR program projects that had increased due to change orders, six (67%) were greater than or equal to \$5,000 or

20% of the total project and thus required the third-party cost reasonableness review. All tested projects had appropriate NSD review, approval, and third-party cost reasonableness assessments.

NSD staff explained that cost ceilings exist for instances where the amount needed for repairs is too excessive, and the project will not move forward. However, NSD needs to ensure that pre-bid inspections and project scopes of work are accurate so that costs for change orders align with expected expenses.

## **Recommendations**

- 2.1 Formalize the change order policy for the OOHR program.
- 2.2 Evaluate the OOHR program pre-bid inspection process to ensure major repairs are being included in the project scope and contractor proposals.

### **3 – Agency Subrecipients**

#### **Background**

NSD provides CDBG grants to local non-profit agencies to address CDBG national objectives. *CFR Part § 570.500* defines a subrecipient as a public or private non-profit agency, authority, or organization receiving CDBG funds from the recipient or another subrecipient to undertake activities eligible for such assistance. *CFR Part § 570.200 General Policies. Determination of Eligibility* states that activities funded by CDBG funds must meet five national standards, including national and primary object, cost reasonableness, compliance with Act 105, and environmental review.

*NSD Policies 07-06 Monitoring Standards and 07-07 Subrecipient Monitoring and Formal Visits* outline internal procedures on their CDBG program and monitoring requirements. In addition, NSD explained several CDBG monitoring procedures in the FY21/22 CAPER. The following is a list of NSD's CDBG program and monitoring requirements to ensure compliance with federal requirements:

1. Contracts will be executed between the subrecipient and the City, with program objectives stated in the subrecipient/City department contract or memorandum of agreement.
2. Payment to non-City project sponsors will be made on a reimbursement basis contingent upon the agency's submittal of supporting source documents and progress reports.
3. Progress reports are checked to ensure measurable progress is made to achieve the goals.
4. All subrecipient-submitted expenses and financial statements are reconciled and approved by City staff for accuracy, eligibility, reasonableness of expenses, and proper use of funds based on award.
5. Desk audits are performed on subrecipients.
6. Formal site visits are conducted throughout the year as needed.

We wanted to ensure that agencies that received CDBG funds for various programs were eligible per the federal requirements. Therefore, we obtained documentation regarding CDBG eligibility requirements and interviewed NSD staff. We tested agency subrecipients for CDBG eligibility. In addition, we evaluated agency files to determine if NSD was effectively monitoring the subrecipients.

#### **We confirmed that select subrecipient agencies met federal eligibility requirements for CDBG-funded programs.**

We selected seven agencies and tested their files for compliance with both federal and NSD eligibility guidelines. The total amount of funds awarded was \$1,199,742. Results showed that all seven of the agencies met the federal requirement for receiving CDBG funds: compliance with Section 105, national objectives, primary objective,

environmental review, and cost principles. We found that two of the tested subrecipients did not have the subrecipient monitoring checklist. NSD staff explained that these two subrecipients received CDBG funds to improve or repair a public facility; therefore, these awards follow the public facilities process which does not require the checklist. NSD staff advised that they have revised their process and now require that staff complete a pre-contract checklist for all CDBG awards for public facilities.

**Some of the tested agency files needed documents required for accurate monitoring.**

*Part § 200.329 Monitoring and Reporting Program Performance* requires that grantees monitor the performance of subrecipients given CDBG funds to ensure compliance with federal guidelines. Accordingly, we inspected seven agency files for conformity with NSD standards. We verified that all work completed received a final inspection by NSD staff, and that payment requests were on file and appropriately signed. In addition, we recalculated invoices for accuracy, drawdown requests, and change order requests.

Overall, we found that NSD staff had properly inspected and approved all required documents. However, only some of the files selected had adequate documentation to support some of the payments. For example, we found one subrecipient where the payment application on file did not correspond to the contract provided; this was due to a change in scope for the program. In addition, many payment applications were for positions supported by CDBG funds, but only some files had timesheets or paystubs to confirm the hours worked. Additionally, some files were missing payment applications or detailed invoices for change order requests.

NSD staff confirmed that they knew about some of these shortcomings. Prior to FY20, file monitoring for agencies was a manual process; there were times when documents were missing, and subrecipient files were incomplete. However, NSD now conducts risk assessments to rank agencies on their ability to meet eligibility and monitoring standards. Agencies found to be riskier are less likely to receive CDBG funds or have to undergo more stringent monitoring. Our samples were selected from the 2018-19 fund year. Further, NSD staff now perform desk audits on all invoices submitted by agencies for reimbursement payments; thus, reducing the amount of missing or incomplete paperwork in subrecipient files. NSD staff provided all missing or incomplete paperwork for the sample tested.

## **Recommendation**

3.1 Review active subrecipient files for missing documentation and update as needed.

## **4 – Drawdown Requests**

### **Background**

NSD tracks the disbursement of CDBG funds using SAP, a shadow report, and HUD's IDIS system. The shadow report is an excel spreadsheet that is the bridge between SAP and IDIS. The shadow report identifies the CDBG expenditures from SAP that have been, or will be, requested for drawdown through IDIS. Drawdown requests are identified in IDIS with a voucher number. NSD lists the IDIS voucher number on the shadow report. NSD combines numerous CDBG expenditures in a single drawdown request.

NSD *Policy 1-21-1* outlines the procedures to monitor federally funded programs and expenditures using the shadow report. The purpose is to ensure funds are being expended in a timely manner and are in keeping with award amounts. Additional objectives are to ensure that funds are used in the correct fund year, posted to the proper accounts, and are accurate, allowable, and reasonable.

We met with NSD to review its drawdown processing for requesting HUD reimbursements. In addition, we pulled SAP reports and confirmed payments to vendors, and cross-referenced totals to both the shadow report and IDIS.

### **Results**

**Testing confirmed that drawdown requests corresponded to CDBG transactions in SAP. However, system limitations made it difficult and time consuming to track specific payments in SAP to disbursements in IDIS.**

We reviewed 17 invoices for OOHR program and CDBG agency payments and tested for correct posting in SAP of the fund year, fund center, and general ledger (GL) account. We found that NSD had posted the CDBG expenditures to the correct fund years, fund centers, and GL accounts.

Further, NSD provided the voucher number and IDIS screenshot for the tested drawdown requests. We were able to correlate the voucher number on the IDIS report to the shadow report, and from the shadow report we confirmed the expenditures in SAP. NSD staff reported that the volume of transactions, combined expenditures in drawdown requests, and multiple grant years make it difficult to correlate CDBG transactions in SAP to IDIS and vice versa. Staff advised that they do not have a grants management system that would automate and take the place of the shadow report. In addition, staff indicated that there is not a place in SAP to record the corresponding IDIS voucher number.

## **Recommendation**

- 4.1 Evaluate the need for a grants management system, and/or work with Finance Business Enterprise Division to determine if there is a way to identify the IDIS voucher number(s) in SAP for the CDBG transactions.



## **Scope, Methods, and Standards**

### **Scope**

Since FY19, NSD received over \$65.6 million in CDBG funds. We reviewed the Department's processes to ensure its administration, monitoring, and reporting on CDBG entitlements complied with federal and internal requirements between FY19 and FY23.

The internal control components and underlying principles that are significant to the audit objectives are:

- Control Activities
  - Management should design control activities to achieve objectives and respond to risks.
- Information and Communication
  - Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.
- Monitoring Activities
  - Management should identify, analyze, and respond to risks in achieving the defined objectives.

### **Methods**

We used the following methods to complete this audit:

- We reviewed HUD guidelines and policies for CDBG-funded programs.
- We reviewed NSD's internal policies on administering and monitoring CDBG-funded programs.
- Interviewed NSD staff about their policies and procedures.
- We assessed NSD timely-use ratio to assess compliance with guidelines.
- We recalculated invoices for mathematical accuracy.
- We tested subrecipient homeowner and agency files for accuracy, completeness, and compliance with federal and NSD guidelines.
- We ran reports in SAP for CDBG programs and compared totals to the Shadow report and IDIS requests for reimbursement.
- We selected a CDBG-funded position and confirmed the salary was listed in the correct GL account and fund center.
- We reviewed totals to ensure charges were allowable per HUD guidelines.

Unless otherwise stated in the report, all sampling in this audit was conducted using a judgmental methodology to maximize efficiency based on auditor knowledge of the population being tested. As such, sample results cannot be extrapolated to the entire population and are limited to a discussion of only those items reviewed.

## **Data Reliability**

We assessed the reliability of SAP, shadow report, and IDIS data by (1) performing electronic testing, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that these data were sufficiently reliable for the purposes of this audit.

## **Standards**

We conducted this performance 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. Any deficiencies in internal controls deemed to be insignificant to the audit objectives but that warranted the attention of those charged with governance were delivered in a separate memo. We are independent per the generally accepted government auditing requirements for internal auditors.