APPALACHIAN REGIONAL COMMISSION
A Proud Past, A New Vision

Office of the Inspector General

July 20, 2003

Memorandum for The Federal Co-Chair
ARC Executive Director

Subject: OIG report 03-15 —ARC Grant MD-6184-78-I-207
Maryland Department of Housing and Community Development

Attached is a copy of the subject report dealing with the grant to the Maryland Department of Housing and Community Development. The grantee had received $4.62 million in funding as of June 30, 2002. There were seven recommendations and $146,852 in questioned costs. Further, approximately $670,000 was identified as potential funds to be put to better use as the funds were currently unused. Follow-up and oversight by ARC should result in the resolution of many of the issues raised in the report. This report will remain open pending receipt of your management response to your proposed actions.

Please contact me if you have any questions on this issue.

Clifford H. Jennings
Inspector General

Attachment

Cc:
Director for Program Operations
State Alternate
State ARC Program Manager

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APPALACHIAN REGIONAL COMMISSION
OFFICE OF INSPECTOR GENERAL

AUDIT OF GRANT FUNDS

MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Report No. 03-15
July 2003

Prepared by
Leon Snead & Company, P.C.

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July 14, 2003

Appalachian Regional Commission
Office of Inspector General
1666 Connecticut Avenue, N.W.
Washington, DC 20009

Leon Snead & Company, P.C. has completed an audit of grant MD-6184-78-I-207 awarded by the Appalachian Regional Commission (ARC) to the Maryland Department of Housing and Community Development (MDHCD). The audit was performed at the request of ARC Office of Inspector General (OIG) to assist in its oversight of ARC grant activities.

The audit objectives were to determine if: (a) the grant expenditures were allowable, allocable, and reasonable; and (b) the grantee complied with the grant requirements and applicable laws and regulations. The audit was performed in accordance with Government Auditing Standards, OMB Circulars A-87 and 102 and the ARC grant agreement. The audit covered grant expenditures recorded on projects during the period March 1, 1991 through June 30, 2002. Audit work at the grantee's office was completed on April 18, 2003.

The audit determined that the ARC funds expended by the grantee on sub-grant activities were allowable, reasonable, and properly allocated. However, we were unable to verify $146,852 in grantee administrative costs charged to the grant because adequate supporting documentation was not available. Also, there has been a substantial amount of unused funds (about $670,000) on the grant for over 5 years. These funds could possibly be directed to projects with higher priorities. It was also noted that the grantee was not obtaining an annual audit as required by ARC. These audits could improve the internal controls over grant operations and improve the level of oversight of ARC and the grantee.

A draft report was provided to ARC program officials for comment on May 23, 2003. Written comments were received on June 30, 2003, and the report was revised to give consideration to the comments where necessary. The comments are also included in their entirety as Appendix B.

Leon Snead & Company, P.C. appreciates the cooperation received from ARC and grantee personnel during the audit and the positive response to making improvements.

Leon Snead & Company, P.C.

Leon Snead & Company, P.C.

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Introduction

Leon Snead & Company, P.C. has completed an audit of expenditures under grant number MD-6184-78-I-207 awarded by the Appalachian Regional Commission (ARC) to the Maryland Department of Housing and Community Development (MDHCD). The audit was performed at the request of ARC Office of Inspector General (OIG) to assist them in carrying out their oversight of ARC grant activities.

The Appalachian Regional Commission authorized the State of Maryland to administer the Appalachian Housing Program in accordance with provisions of the Appalachian Regional Development Act of 1965. The MDHCD is the cabinet-level State agency authorized to administer the program and the Maryland Appalachian Housing Fund (MAHF) under which the program is funded. The ARC grant was awarded in September 1978 to establish and operate the MAHF and provided for several types of loans and/or sub-grants to be awarded for developing low and moderate income family housing in the Maryland Appalachian region.

The grant agreement restricted the use of ARC-provided funds to making loans and/or sub-grants only for technical assistance, project planning, site development, and rental rehabilitation or demonstration activities. The grant also provided funds to MDHCD for costs to administer the program and MAHF. As of June 30, 2002, the grantee had received $ 4.62 million in funding from ARC under the grant and had made loans and grants to sub-grantees totaling $4.45 million and charged $146,852 in administrative expenses to the grant.

Objectives, Scope, and Methodology

The audit objectives were to determine if: (a) the expenditures charged to the grant by the grantee during the audit period were allowable, reasonable, and properly allocated; (b) matching funding, if required, was achieved and adequately documented; and (c) provisions of the grant agreement and applicable laws and regulations were complied with. Our audit covered $1.7 million in expenditures approved by ARC from March 1, 1991 through June 30, 2002 for sub-grantee projects as well as $135,614 in administrative expenses charged during that period. Audit work was conducted at the MDHCD offices in Crownsville, Maryland on April 14 – 18, 2003. We also visited ARC Headquarters to obtain preliminary information.

We reviewed available grantee accounting and project management records and supporting documentation for expenditures reported. We evaluated and discussed grantee procedures for ensuring compliance with the grant agreement and applicable laws and regulations. We selected a sample of sub-grant projects approved during the audit period to evaluate expenditures and the activities funded to determine if they were consistent with the ARC grant requirements. Also, we tested applicable internal control procedures necessary to achieve the audit objectives.

The audit was performed in accordance with generally accepted auditing standards, *Government Auditing Standards, OMB Circular A-87; Cost Principles for State, Local, and Indian Tribal Governments, and OMB Circular A-102; Grants and Cooperative Agreements with State and Local Governments.*

FINDINGS AND RECOMMENDATIONS

A. Effective Use of Grant Funds.

As of June 30, 2002, the grantee records showed that they had $203,830 available under the grant to support new projects and $443,857 available for administrative costs. Some of these amounts were from funds provided by ARC but not used to fund approved sub-grants or loan projects and some were from loan interest payments. Under the ARC grant agreement, the grantee may retain interest payments and use them for new activities as approved by ARC. According to ARC records, as of March 26, 2003, it had $22,386 in funding that had been obligated on the grant but not provided to the grantee.

There have not been any new loans or sub-grants approved under this grant since August 1998. This appears to be due to a lack of management attention by both ARC and grantee personnel that resulted from frequent turnover in project management personnel for both parties. Grantee officials told us that another factor for them was the relatively low amount of funding on the ARC grant compared to the other larger Federal grants they have to manage and the higher priority given to those grants.

We believe that the grantee should make effective use of these funds or ARC should re-program them (about $670,000) to support projects of higher priority. Our audit identified a related problem that needs to be resolved in order to take this action. We identified a $336,636 refund that the grantee sent to ARC in January 1995. We could find no adjustment for this amount in either the grantee or ARC grant financial records. When we notified ARC of this matter, they determined that the refund was never credited back to the grant funds. They have since done so and now show available funding of $389,022 for the grant. However, in discussing it with the grantee, their grant accounting records did not show this amount anywhere. They speculated it might have been a payment made by ARC in error and MDHCD never recorded it as a receipt on the grant and simply refunded it to ARC. It remains unclear what the exact amount of remaining unused funding is under the grant. The matter needs to be resolved and the appropriate records corrected.

Recommendations

ARC should:

1. Coordinate with grantee personnel to determine what the $366,636 refund amount was for and take appropriate action to ensure that the amount is properly recorded on both ARC and grantee accounting records so an accurate current grant funding balance can be identified.

2. Re-evaluate this grant to determine if it is consistent with current ARC goals and needs, if the grantee has current valid requirements, and if continued funding is justified. If so, the grantee should be required to submit projects for approval to make timely and full use of the available funds. Otherwise, the grant should be terminated immediately and the remaining total funds put to better use.

Management Response

ARC continues to work with the grantee to verify that the large refund received in 1995 was attributable to a project that was terminated soon after approval. ARC records reflect that this explanation of the recovery is most probable. The Commission is working with the State ARC office and grantee to determine whether the grant is meeting current needs and will either close out the grant or make use of the funds in a timely fashion.

Auditor's Comments

The actions described by ARC are considered responsive to the recommendations. The recommendations can be resolved pending follow-up by the OIG at a later date.

B. Pre-award Costs on Sub-grants

The grantee included provisions in the agreements for all five of the sub-grants we reviewed that allowed the sub-grantee to bill for costs that had been incurred several months, and in one case, several years before the sub-grant award date. We did not find any documentation in the project files to demonstrate that the grantee had either obtained specific approval from ARC to fund such pre-award costs, had given the sub-grantee written approval to incur such costs prior to the agreement date, or had otherwise established some means for monitoring or controlling any costs the sub-grantee might incur.

Pre-award costs under grants and sub-grants are not allowable unless specifically authorized by the Federal grantor agency. Allowing sub-grantees to incur costs prior to the grant award without written approval and without establishing formal conditions and limits on the amounts can result in unnecessarily increased risks for both the grantee and ARC. Since we observed this condition on all of the sub-grants we reviewed it appeared to be a general practice by the grantee for grants during the time period we audited. We were unable to determine why such an approach was considered necessary and what, if any, actions were taken to minimize risks because none of the current grantee program officials had knowledge about the grant, sub-grants, or specific actions taken.

One of the sub-grants reviewed was awarded on November 1, 1998 to the Garrett County Community Action Committee for the Overlook North project. The amount was $200,000. Section 7 of the agreement allowed the sub-grantee to "...seek funds to pay for certain projected costs anticipated to be incurred as well as certain costs actually incurred on or after April 22, 1996." We saw no documentation in the grant records to show either what the "certain costs" were or that the grantee and ARC had officially approved these costs in April 1996. The other four sub-grant agreements had the same provision except that the beginning date for incurring costs was 2-3 months before the award date. We recognize the need in some cases to authorize pre-award costs for construction projects such as covered by these sub-grants. However, we do not believe it is either acceptable or prudent to do so without written prior approval describing clearly the terms and conditions that apply.

We are not taking exception to the costs reimbursed because the sub grantee's projects were later approved by ARC. However, we believe the grantee should approve pre-award costs only in exceptional cases and only after obtaining ARC approval.

<u>Recommendation</u>

3. If ARC decides to continue funding and administering grant MD-6184-78-I, the grant coordinator should formally and immediately notify the grantee that pre-award sub-grant costs will be considered unallowable under the grant unless ARC has formally provided prior approval and the sub-grantee has been provided advance written notice of terms and conditions under which the costs can be incurred.

Management Response

If the decision is made to continue the grant, ARC will work with the grantee within the context of a contract revision to resolve this issue.

Auditor's Comments

The proposed action is considered responsive to the recommendation. The recommendation should be resolved pending follow-up by the OIG at a later date.

C. Incorporating ARC Provisions Into Sub-Grants

ARC grant MD-6184-78-I contained the ARC general provisions for *contracts* rather than the general provisions for *grants* normally incorporated into all grant agreements. The grantee was likewise incorporating the same *contract* provisions into all the sub-grants it awarded. As a result, neither the grantee nor sub-grantees were subject to all the requirements normally applied to ARC grants.

Under ARC procedures, a document titled "Part II, Appalachian Regional Commission Grant Agreement: General Provisions" is normally incorporated into ARC grants as an attachment to serve as requirements the grantee must follow. ARC also has a separate "Part II, ARC General Provisions for Contracts" that applies to contractors. Grantees and contractors are required to incorporate those same requirements in all sub-grants and sub-contracts awarded using ARC funding.

Some of the provisions are similar in the two Part II documents. However, there are some provisions that are unique to the Part II for grants which both the grantee and sub-grantees should be expected to follow. For example, Article 1 of the Part II for grants cites OMB circulars that apply to administering grants and are additional requirements that grantees and sub-grantees must comply with. The Part II for contracts does not reference these OMB requirements. Also, Article 14 of the Part II for grants contains certain record-keeping requirements that are important for sub-grant--those requirements are not addressed in the Part II for contracts.

We were unable to determine why or how the incorrect Part II was incorporated into the grant because it was awarded in 1978 and the current ARC grant program staff contacted during the audit did not have any knowledge of the details on this grant. We confirmed with the ARC General Counsel's office, however, that MD-6184-78-I was a grant rather than a contract and that the Part II provisions for grants should apply.

Action is needed to correct this problem and ensure that the grantee and sub-grantees are aware of and following the appropriate ARC grant requirements.

Recommendation

4. If ARC decides to continue funding and administering grant MD-6184-78-I, the grant agreement should be amended to include the correct Part II for grant provisions that should apply to both the grantee and sub-grants.

ARC/Grantee Response

ARC will work with the grantee to revise the contract to resolve this issue if the grant is continued.

Auditor's Comments

The proposed action is considered responsive to the recommendation. The recommendation should be resolved pending follow-up by the OIG at a later date.

D. Complying With Grant Audit Requirements

The grantee did not have annual, independent audits performed during the period audited as required by the ARC grant agreement. Section 2-2.3 of the agreement requires the grantee to have an annual, independent audit performed of the agreement, the Maryland Appalachian Housing Fund (MAHF) and related financial sub-accounts, and individual projects (sub-grants or loans) funded under the ARC grant. The purpose of the audits were to ascertain whether or not the funds disbursed from the MAHF to individual projects were consistent with (a) ARC-approved budgets; (b) the approved project requirements; and (c) restrictions imposed by the grant agreement for Section 207 and 302 activities.

We discussed this matter with the staff currently responsible for the grant. They stated that when they assumed responsibility for the grant in about 1994, one of the things they questioned was the special audit requirement in Section 2 of the grant. They believed that the requirement seemed duplicative and unnecessary since the grantee organization had annual audits performed on its activities under the single audit provisions of the OMB Circular A-133. They thought discussions were held with ARC personnel responsible for this grant about eliminating the requirement or obtaining a waiver. However, they were not certain that any official action was ever taken on the issue and could not provide any documentation to verify that this requirement was officially eliminated.

The most recent version of the grant agreement that we were provided still contained the requirement and none of the 15 amendments to the agreement addressed this matter. So we considered it a valid requirement under the agreement. The grantee staff confirmed that although it appeared the requirement had not been officially waived, they had neither arranged for the audits to be performed nor submitted any audit reports to ARC as required by the agreement. We also asked the ARC grant manager why they never noticed the lack of reports and took action to enforce the requirement and were told they could only subscribe it to staff turnover and lack of attention on this grant.

By not having these audits performed, ARC was denied an important means for ensuring that ARC funds were effectively administered and that restrictions and other requirements in the agreement were complied with. We reviewed some of the reports for A-133 audits performed on the grantee and some of the sub-grants and found that this grant and the ARC funds were not always included in the audit scope and testing. While the A-133 audits provide some perspective on the grantee's or sub-grantee's overall controls, they do not in our opinion provide the level of assurance over the ARC grant and funds intended by the requirement in the grant. Therefore, the audit requirement should remain and be complied with.

Recommendation

5. If ARC decides to continue funding grant MD-6184-78-I, the grantee should be required to comply with the special audit provision described in Section

2-2.3 of the agreement and the ARC coordinator should ensure that the audit reports are included in the annual report submitted to ARC.

Management Response

If the decision is made to continue the grant, ARC will work with the grantee within the context of a contract revision to resolve this issue.

Auditor's Comments

The proposed action is considered responsive to the recommendation. The recommendation is resolved pending follow-up by the OIG at a later date.

E. Maintaining Supporting Records

None of the supporting records and documents for administrative costs incurred by the grantee and charged to grant MD-6184-78-I-207 during the audit period were available for examination during the audit. We were told that all such records and documents had been destroyed or discarded. As a result, we could not verify that the $146,852 in administrative costs charged to ARC during the audit period were allowable, reasonable, and properly allocated.

ARC general provisions require the grantee to maintain records including time records, payroll, invoices, and vouchers to support expenditures on the grant. The grantee must also allow the ARC or its representative to audit the books, documents, records, and papers involving transactions on the grant until three (3) years after final payment. At the time of the audit, the grant had not been completed or terminated and final payment had not been made. Therefore, it was still open and active.

Using summary information from the grantee's accounting records, we selected some of costs recorded during the audit period and requested to see the supporting documentation. We were told by the grant accounting manager that none of the supporting documentation such as timecards, payroll records, and travel vouchers could be located. We were subsequently told that all of the supporting documents for the grant administrative costs had been disposed of, which was also confirmed by other staff responsible for financial transactions on the grant.

There were two primary reasons the supporting documentation had not been maintained for this grant. First, responsibility for the grant had been reassigned to several different offices and staff during the audit period and the new staff did not become familiar with the specific grant provisions. Second, most of the other grants managed by the grantee had specific timeframes for completion--usually 1 to 2 years. The ARC grant had no specific completion date and had been on-going since 1978. The grantee's record retention policy permitted supporting accounting documents to be destroyed after 3 years once all audit requirements had been satisfied. Since grantee officials believed the annual A-133 audits satisfied their requirements, as discussed in Finding D, they followed their normal procedure and destroyed the records for this grant also.

<u>Recommendation</u>

6. ARC officials should review the specific grant agreement requirements for maintaining supporting documentation on costs with grantee project staff and require the grantee to maintain adequate documentation until final payment is made and the grant is properly closed out.

Management Response

If the decision is made to continue the grant, ARC will work with the grantee within the context of a contract revision to resolve this issue.

Auditor's Comments

The proposed action is considered responsive to the recommendation. The recommendation is resolved pending follow-up by the OIG at a later date.

F. Final Costs On Pleasant View East Sub-Grant

There was an inconsistency between the amount of expenditures claimed by the sub-grantee on the Pleasant View East project and the amount of expenditures reflected in the auditor's report on the sub-grantee during the period. The grantee reimbursed the sub-grantee a total of $ 169,300 under three separate requests for funding from the sub-grantee. The supporting documentation submitted with the requests showed that all of the contractors had billed the sub-grantee on or before December 9, 1997. Based on that information, it appeared to us that the work had been completed and paid for by the sub-grantee.

However, in reviewing an audit report on the sub-grantee's financial activities for the fiscal year ended September 30, 1998, we observed that the report showed the sub-grantee received $169,300 under the sub-grant during the period but only had expenditures totaling $71,368. There was no documentation in the project files indicating that the sub-grantee either subsequently disbursed the remaining $ 97,932 or refunded that amount to the grantee.

We did not visit the audit firm or review their work papers. We discussed the matter with grantee officials but were unable to satisfactorily resolve the question. Therefore, the grantee needs to follow-up on this matter and obtain a refund if applicable.

Recommendation

7. ARC should require the grantee to obtain final costs incurred by the sub-grantee on the Pleasant View East project, have them audited if they have not already been, and obtain any refunds or adjustments that may be applicable.

Management Response

ARC will follow up with the grantee to resolve the issue of final costs on this project.

Auditor's Comments

The proposed action is considered responsive to the recommendation. The recommendation is resolved pending follow-up by the OIG at a later date.

APPENDIX A

SUB-GRANTS AWARDED DURING THE AUDIT PERIOD

Sub-Grantee	Amount
Garrett County CAC – Center St. School	$270,600
St. Peter-Paul Monastery Cumberland	$20,300
Garrett County CAC – Woodbridge II	$78,750
Garrett County CAC – Oakwood East *	$126,570
Lonaconing Rehab Alleghany	$75,000
Washington CAC – Community Estates	$63,092
Garrett County CAC – Yough West *	$220,197
Garrett County CAC – Glades West *	$227,052
Western Maryland Interfaith	$183,318
Bethel Corporation	$148,000
Western Maryland Interfaith	$144,240
Garrett County CAC – Pleasant View East *	$169,300
Garrett County CAC – Overlook North *	$200,000

* Selected for review during audit

APPENDIX B

MANAGEMENT RESPONSE

facsimile transmittal

ARC

from the desk of Jeffrey H. Schwartz, Ed. D.
Acting Director
Program Operations Division
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Telephone: 202-884-7721 Fax: 202-884-7691

To:	Leon Snead	**Fax Number:**	301-738-8210
From:	Jeff Schwartz	**Date:**	6/30/2003
Re:	Response to draft audit report of ARC grant funds to Md. Dept. of Housing and Community Development	**Pages:**	1 (including cover sheet)
CC:	file		

☐ **Urgent** ☐ **For Review** ☐ **Please Comment** ☐ **Please Reply** ■ **As requested/ promised** ☐ **For your information**

The Commission is working with the State ARC office and the grantee to determine whether the grant is meeting current needs. Arrangements will be made to either close out the grant or make use of the funds in a timely fashion.

If the parties determine to close out the grant, remaining grant funds will be recovered to the grant account and then deobligated. If the decision is made to continue the grant, ARC will work with the grantee in the context of a contract revision to resolve issues raised by Recommendations 3, 4, 5, and 6 of the Draft Report concerning pre-award subgrant costs as well as appropriate contract attachments, and audit and record keeping requirements.

ARC continues to work with the grantee to verify that the large refund received by the Commission in 1995 under this grant was attributable to a project (Baldwin House in Washington County) that was terminated soon after approval. ARC records reflect that this explanation of the recovery is most probable.

ARC will also follow up with the grantee to resolve the issue of actual expenditures for the Pleasant View East project noted in Recommendation 7.