
**APPALACHIAN REGIONAL COMMISSION
OFFICE OF INSPECTOR GENERAL
AUDIT OF GRANT AWARD**

**Kentucky Housing Corporation
Frankfort, Kentucky**

**Final Report Number: 17-10
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Bonadio & Co., LLP completed an audit of grant number KY-16798-C2-2012 awarded by the Appalachian Regional Commission (ARC) to the Kentucky Housing Corporation (KHC). The audit was performed to assist the Office of Inspector General in carrying out its oversight of ARC grant funds.

The primary objectives of the audit were to determine whether: (1) program funds were managed in accordance with the ARC and Federal grant requirements; (2) grant funds were expensed as provided for in the approved grant budget; (3) internal grant guidelines, including program (internal) controls, were appropriate and operating effectively; (4) accounting and reporting requirements were implemented in accordance with generally accepted accounting principles (or other applicable accounting and reporting requirements); and (5) the matching requirements and the goals and objectives of the grant were met.

Overall, KHC generally passed down compliance responsibilities to the end recipients of the grant funds and did not have sufficient procedures in place to monitor compliance with the terms and conditions of the grant agreement. Specific performance objectives for the grant were not clearly defined in the sub-grantee applications, and progress and final reports did not clearly identify that the grant funds were used in the site preparation and on-and off-site utility work of the construction. As a result, we were unable to conclude on the achievement of specific objectives.

Bonadio & Co., LLP appreciated the cooperation and assistance received from KHC and ARC staff during the audit.

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BACKGROUND

Bonadio & Co., LLP completed an audit of grant number KY-16798-C2-2012 awarded by the Appalachian Regional Commission (ARC) to the Kentucky Housing Corporation (KHC). The audit was conducted at the request of the ARC, Office of Inspector General, to assist the office in its oversight of the ARC grant funds.

The grant was approved on September 18, 2012 and provided \$500,000 in ARC funds to KHC for the period of January 1, 2013 through October 31, 2013 to provide good quality, and affordable housing for low-income people in eastern Kentucky. On September 24, 2014 the ARC approved the extension of the performance period to January 31, 2016. It was noted that per Amendment Number Two the performance period changed to January 1, 2013 through January 31, 2016.

The grant allowed KHC to pass through funds to local and regional housing service providers who apply for funds through KHC during the agency's annual funding cycle. Per the terms of the grant agreement, KHC's responsibilities included management of the application process, related financial transactions, and documentation of project outcomes and overall monitoring of project activities. After KHC reviewed applications and selected recipients, ARC approved the selection of sub-grantees proposed by KHC. After the grants were awarded, housing construction and rehabilitation activities took place in distressed Appalachian counties. ARC funds were disbursed to the following sub-grantees:

- Federation of Appalachian Housing Enterprises, Inc. (FAHE) \$420,000
- Bell Whitley Housing Initiatives Program \$ 50,000
- Daniel Boone Community Action Agency, Inc. \$ 30,000

Per the documentation provided by KHC, grant funds were used to support the construction and rehabilitation of housing and the construction of housing for low-income families in distressed Appalachian counties of Kentucky. Funds were spent for site preparation and both on-site and off-site utility work. The project was designed to serve those families with the lowest incomes in the sub-grantee service areas.

KHC requested reimbursement of \$500,000 from ARC for grant-related expenses for the period ended January 31, 2016. Matching funds from federal, state and local sources, as reported by the sub-grantees to KHC were \$4,912,558 for the same period. The total reported expenditures for the performance period were \$5,412,558, however due to the nature of KHC's controls over monitoring; this amount could not be verified.

KHC passed all funds through to sub-grantees and did not draw any funds from the grant for its own use or to cover any grant-related costs incurred by KHC. FAHE received a majority of the funds, \$420,000. FAHE, and consequently passed the grant funds through to its "Member Groups" without drawing any funds for its own use. The participating FAHE "Member Groups" and other KHC sub-grantees monitored and reported matching funds from federal, state and local sources in addition to managing the housing construction and renovation projects.

A number of findings were noted related to the overall administration and monitoring of the grant and measures to ensure compliance with the terms and conditions of the grant agreement.

BACKGROUND (continued)

For the majority of the grant period, KHC passed down most compliance responsibilities to the end recipients of the grant funds and did not have sufficient procedures in place to monitor compliance with the terms and conditions of the grant agreement. Beginning in September 2015 KHC implemented additional control and monitoring procedures, however the period of performance which the new procedures covered consisted of only 5 months of the total performance period of 37 months. Since 32 months did not have adequate control procedures in place, this resulted in audit findings. Findings included the absence of, or limitations to, processes for KHC to: provide progress reports to ARC; validate expenditures and matching funds as reported by sub-grantees; and monitor sub-grantee compliance with the specifications of the grant through inspections and the completion of the construction work.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to perform a performance audit of the Kentucky Housing Corporation, Kentucky Appalachian Housing Program for the period January 1, 2013 through January 31, 2016. The purpose of our performance audit was to determine whether (1) program funds were managed in accordance with the ARC and Federal grant requirements; (2) grant funds were expensed as provided for in the approved grant budget; (3) internal grant guidelines, including program (internal) controls, were appropriate and operating effectively; (4) accounting and reporting requirements were implemented in accordance with generally accepted accounting principles (or other applicable accounting and reporting requirements); and (5) the matching requirements and the goals and objectives of the grant were met.

We performed a program review of Grant KY-16798-C2-2012 at the KHC and FAHE offices on December 1, 2016 and December 2, 2016, as well as additional procedures off-site. Our review was based on the terms of the grant agreement and on the application of procedures in the modified ARC Audit Program. The primary criteria used in performing the audit were ARC grant documents, the grant approval, the ARC code, other ARC requirements, federal cost principles, and audit requirements for federal awards. The audit was performed in accordance with the *Government Auditing Standards*.

We reviewed the internal processes and controls at KHC, as well as FAHE, the recipient of the majority of the grant funds. We interviewed the Managing Director of Specialized Housing, Manager of Quality Control for Specialized Housing, and the Manager of Contract Documentation for Specialized Housing at the KHC office and the Vice President of Consulting at FAHE to discuss their procedures in place surrounding grant administration and monitoring. We reviewed controls over the application process, monitoring of the grant and the controls in place for recording, accumulating and reporting costs under the grant. We made inquiries and reviewed documentation regarding whether the goals and objectives of the project funded with ARC funds had been met.

We reviewed documentation provided by KHC and FAHE to obtain an overall understanding of the grant activities, the accounting system, and operational activities. We also reviewed background material which included ARC's grant agreement and related documentation, ARC grant approvals, the KHC grant application to ARC, the sub-grantee applications to KHC, information from ARC's grant management system, other supporting grant documentation and audited financial statements pertaining to KHC.

We selected a sample of 5 construction/rehabilitation units, then examined supporting documentation, which included funding applications, reporting from the sub-grantees, reimbursement requests and performance data maintained by KHC and FAHE to manage and monitor the program. We evaluated the process for compliance with applicable grant requirements and regulations.

The audit results were discussed with KHC representatives at the conclusion of the on-site visit.

SUMMARY OF AUDIT RESULTS

As reported by KHC, the funds disbursed under the grant were used to support the construction and rehabilitation of homeownership housing and the construction of housing for low-income families in distressed Appalachian counties of Kentucky. The grant allowed KHC to pass through funds to local and regional housing service providers. KHC passed-through all funds to three sub-grantees; Federation of Appalachian Housing Enterprises, Inc. (FAHE), Bell Whitley Housing Initiatives Program, and Daniel Boone Community Action Agency, Inc. FAHE received a majority of the funds, \$420,000, who in-turn passed-through funds to its "Member Groups". The participating FAHE "Member Groups" and other KHC sub-grantees monitored and reported the grant funds, reported matching funds and managed the housing construction and renovation projects.

Specific performance objectives for the grant were not clearly defined in the sub-grantee applications, and progress and final reports did not clearly identify that the grant funds were used in the site preparation and utility work of the construction. As a result, we were unable to conclude on the achievement of specific objectives; however, as described by KHC during the audit, the project activities supported by the grant funds were consistent with ARC's goals and objectives, resulting in the construction of 66 housing units and the rehabilitation of 60 housing units in distressed Appalachian counties of Kentucky.

KHC acted as a pass-through organization and passed down compliance responsibilities to the sub-grantees and end recipients of the grant. KHC did not have sufficient procedures in place throughout the majority of the performance period of the grant to monitor compliance with the terms and conditions of the grant agreement. As such, findings were noted related to the overall administration of the grant and procedures to ensure compliance with the terms and conditions of the grant agreement.

FINDINGS AND RECOMMENDATIONS

Monitoring Responsibilities

Information was not available to confirm that the sub-grantee expenditures and matching requirements were met and that inspections were performed timely. This was a result of delays in implementing recommendations previously reported in OIG audit report 14-01, dated November 7, 2013 and also due to the absence of policies and procedures involving matching funds until September 2015.

Sub-grantee Expenditures and Matching Funds

The grant agreement requires the grantee to monitor and administer the grant, ensuring that ARC funds are being appropriately expended and matching funds meet the grant requirements. Through our discussion with KHC management and review of documentation, it was noted that for the majority (32 out of 37 months) of the grant period there were no written processes in place to validate expenses and the matching funds reported by sub-grantees for the ARC-funded expenditures. It was noted that the reimbursement requests from the sub-grantees to KHC for funding include a summary of the ARC funded expenses, state, local and non-ARC federal matching funds in place. Documentation was being provided to KHC to make reimbursement requests however, KHC did not have a process in place for the majority of the grant period to verify the amounts being reported were accurate and met the requirements of the grant agreement.

FINDINGS AND RECOMMENDATIONS (continued)

Monitoring Responsibilities (continued)

Sub-grantee Expenditures and Matching Funds (continued)

Recommendation

Based on our discussion with KHC management, it was noted that during 2015 KHC implemented new grant administration software used in tracking the various grant projects maintained by the KHC. Within this new system it was noted that if the project uses HOME/AHTF funding as the matching funds the supporting documentation for the matching funds can be linked to the ARC Grant funding as support. KHC should continue to use this new system to validate the matching funds reported as HOME/AHTF and should use the new system to identify matching funds which the KHC does not have support for and request additional documentation. KHC should ensure that there process allows them to independently verify the ARC and matching funds reported by the sub-grantees.

Based on our observations and discussions with KHC management, we recognize that corrective action from the previous OIG report was implemented during September 2015; however we recommend that KHC perform a review of the grant expenditures from grant KY-16798-C2 and prior grant periods. We recommend that KHC obtain adequate documentation from the sub-grantees to determine whether the expenditures incurred during the grant periods were allowable.

Management Response

KHC will continue to implement the new system and process that was in place at the time of the review and acknowledged in the recommendation.

Inspection Process

The grant agreement requires KHC to monitor project activity to ensure the funds are being appropriately expended and to ensure successful implementation of the project. Performing site inspections allows the grantee to verify that the actual work was performed. Through discussion with the KHC inspector, it was noted that the inspection work that has been performed at a given location is limited in scope and if an inspection is completed it is typically only performed after final completion of the individual construction/rehabilitation project. Occasionally, if another grant which is funding a project requires an inspection during construction, one will be performed and is included in the ARC grant documentation. This process limits the extent to which the inspectors have visibility into what specific work was performed at the site and what materials were used in the process. ARC funds were intended to be spent on site preparation and utility work, neither of which can be effectively validated through inspection after completion of the project. Even though KHC delegated its responsibility, it is still responsible for establishing a process to monitor the work performed by the sub-grantees.

Recommendation

KHC should update their internal requirements for their project inspections and enhance the overall process to help ensure that the inspectors, when needed, are able to verify the work that was performed and acquire and/or generate additional documentation for the specifics of the project that were verified. This will likely require additional inspections during the course of the projects, or verification that inspections by sub-contractors were performed at the appropriate time, and/or in coordination with other local inspectors already engaged to inspect the project. The use of the construction plan specifics, change orders, and the inspection forms completed showing an itemized breakdown of the project goals will assist in aligning the project completion with the grant objectives.

FINDINGS AND RECOMMENDATIONS (continued)

Monitoring Responsibilities (continued)

Inspection Process (continued)

Management Response

KHC will update their internal requirements to include more timely and thorough inspections of the work performed on the ARC assisted units. This will be conducted using both internal KHC inspection staff and sub-recipient inspection records.

Progress Reports

Per the ARC Grant agreements, grantees are required to submit interim and final reports in prescribed formats as noted in the ARC Grant Administration Manual. Interim reports are required to be submitted every 120 days during the grant period and the final report is required at the completion of the grant period. The narrative report format includes the following sections: cover page, background, recent/upcoming activities, progress made toward project outcomes, problems encountered, outlook for program continuation and sustainability, and for the final report only conclusions and recommendations. These narrative reports allow for the assessment of progress against anticipated outputs and outcomes. This enables the grantee and ARC to assess whether the project is progressing as expected and if the project has achieved or will achieve its stated goals and objectives within the appropriate timeframe.

It was noted that KHC did not consistently submit interim report every 120 days during the grant period and interim reports were not submitted for the periods prior to their request for a grant extension. KHC submitted reports to ARC on March 20, 2015, July 7, 2015, November 20, 2015, and April 21, 2016. It was noted during our audit, that some of the funding requests submitted by KHC for draws on ARC grant funds were not supported by narrative progress reports. It was noted that the final narrative report was not submitted within 30 days of the completion of the period of performance, as required by the grant, nor was the final report submitted by KHC in the proper format. It was noted that subsequent to reimbursement requests progress reports were submitted to the ARC which included some of the narrative format outlined by the ARC.

This finding was previously noted in OIG audit report 14-01, dated November 7, 2013.

Recommendation

For future grants, KHC should submit all reports required per the grant agreement in a timely manner and should include the required reports when submitting funding requests. Progress reports should be submitted in accordance with the reporting requirements established by ARC. The reports should include the required narrative elements, along with reimbursement request. Creating and submitting the proper reports at the specified periods will allow both KHC and ARC to gauge progress against the specified outcomes and outputs, as well as provide details on the financial status of the grants. Their reports should be submitted regardless of whether or not there has been activity with the grant funds. This will also help to ensure that some of the monitoring and administration elements required by the grant are being consistently completed.

Management Response

KHC management have reviewed their processes related to submission of funding requests and have incorporated guidance to staff to ensure that requests for funding contain all required documentation and are processed in a timely manner. Progress on this can be seen in subsequent funding request submissions, such as the KY-16798-C3 grant.

FINDINGS AND RECOMMENDATIONS (continued)

Timing of Grant Expenditures

The grant requires that funds are to be expended during the approved grant period. We noted that the grant was originally approved on September 18, 2012 for the period of January 1, 2013 through October 31, 2013. On September 24, 2014 the ARC approved the extension of the performance period to January 31, 2016. From the time of November 1, 2013 through September 23, 2014, the grant period had expired. When reviewing KHC's documentation it was noted that some of the construction may have occurred during the period of expiration. Due to the lack of documentation maintained and the nature of the inspection process in place (as previously discussed) it was difficult to determine when the actual construction work took place and whether potential ineligible expenditures occurred.

Recommendation

KHC should obtain documentation from the sub-grantees that detail the nature and timing of the construction work performed during November 1, 2013 through September 23, 2014, to determine whether ineligible expenditures may have occurred. KHC should also obtain adequate documentation from the sub-grantees on a continuous basis for future grants. This may include contractor invoices, project status reports, sub-contractor inspection reports, etc. KHC should also enhance the inspection process to ensure that the inspectors can effectively validate the timing of the work performed. This will likely require additional inspections during the course of the projects, or verification that inspections by sub-contractors were performed at the appropriate time, and/or in coordination with other local inspectors already engaged to inspect the project. Requiring additional documentation and an enhanced inspection process will assist in validating the timing of the work performed.

KHC should ensure that, when needed, they are applying for grant amendments in a timely manner. KHC should be appropriately monitoring the grant period, in order to determine whether an amendment to extend the grant period is needed and to ensure that they are applying for an extension of the grant period before the period expires. As part of monitoring the grant period, KHC should also ensure that funds being expended fall within the approved grant period, to ensure that expenditures are eligible for reimbursement.

Management Response

KHC will begin collecting more detailed documentation from the sub-recipients, showing the timing and type of work performed at each ARC assisted unit. The additional oversight will ensure that documentation of the timing of the work performed fell within the approved grant period. If circumstances make it necessary to request an extension of the grant period, KHC will ensure that the extension request to ARC is made within the original grant period.

OTHER OBSERVATIONS

Grant Management Software Upgrade

Based on our discussion with the Manager of Contract Documentation at KHC it was noted that they implemented a new software package in September 2015 which allowed for additional monitoring and supervision of the grant. The software links all aspects of the various grants administered by KHC, allowing for the system to track, report and disburse funding for the sub-grantees. Additionally, the process of the sub-grantee submitting progress reports and draw requests to KHC is enhanced as the sub-grantee electronically submits supporting documentation for review. This supporting documentation is maintained electronically and was available for our review. We performed a walkthrough of the new monitoring procedures in place. As a result of the implementation of this new software package, we noted that a number of improvements were made to the monitoring process. Improvements included the monitoring of matching funds, supporting documentation being readily available, and the linking the outcomes of the various grants used on each project.