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Review Of Certain Aspects Of
The Grand Rapids, Michigan,
Model Cities Program B-171500

Department of Housing and
Urban Development

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

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NOV 1 1973



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON DC 20548

B-171500

The Honorable Gerald R. Ford
Minority Leader
House of Representatives

Dear Mr. Ford

By letter dated February 27, 1973, you requested GAO to investigate the Model Cities Program in Grand Rapids, Michigan. During subsequent discussions with your office, we agreed to review certain activities of the Economic Development Corporation (EDC), contractor for the economic development project of the Grand Rapids Model Cities Program, and to obtain information on Freedom Homes, Inc., contractor for a home construction and rehabilitation project of the program. You gave us various documents containing charges of improprieties in EDC's handling of funds, which we agreed to review. The charges were categorized as

- questionable loan transactions,
- questionable grants and consultant contracts,
- conflicts of interest, and
- kickbacks of funds to obtain loans.

Our review of the charges concerning questionable loan transactions disclosed that EDC did not always adhere to its loan guidelines which required it to evaluate the potential recipients' abilities to repay loans. As of May 31, 1973, payments on the loans we reviewed were as much as 13 months delinquent. EDC has since taken legal action to recover the amounts outstanding on certain loans. (See appendix, p. 4.)

We found no basis for four of five charges concerning questionable grants and consultant contracts. We found evidence, however, that part of the fifth charge was correct--services provided to EDC by a consultant were of poor quality. (See appendix, p. 9.)

The contract between EDC and the city of Grand Rapids provides that possible conflict-of-interest situations are to be referred to the Grand Rapids city attorney for a final

determination. We gave the information we had obtained concerning possible conflict-of-interest situations to the city attorney to examine. He ruled that the situations were either not conflicts or were conflicts not contrary to the public interest. An official of the Department of Housing and Urban Development (HUD), which is responsible for administering the Model Cities Program at the Federal level, concurred with these rulings. (See appendix, p. 17.)

We found no evidence to support the three charges that loan recipients had made kickbacks to obtain loans from EDC. In two instances, the individuals named in the charges had not received EDC loans. The third individual had received a loan from EDC, but we found no evidence that a kickback had been made. (See appendix, p. 20.)

We are recommending to the Secretary of HUD that the Department follow up to evaluate the adequacy of the actions taken by the city and EDC to correct the problems noted in EDC's administration of the economic development project. (See appendix, p. 25.)

The information we obtained concerning the home construction and rehabilitation project operated by Freedom Homes, Inc., showed that little had been accomplished for the amount of funds spent. During the project's 2-year existence, Freedom Homes, Inc., spent \$193,300 and only partially completed the construction of two homes. (See appendix, p. 26.) Details of our findings are contained in the appendix to this letter.

At your request, we discussed with the mayor of Grand Rapids the results of our review and our tentative conclusions. The city manager and a representative of your office also attended this briefing.

As agreed with your office, we have not given the officials of HUD, the city of Grand Rapids, EDC, or Freedom Homes, Inc., or the individuals named in the report the opportunity to examine and comment on the matters in this report. However, we have discussed our observations with them and have considered their views in finalizing this report.

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Also as agreed with your office, we will provide the Secretary of HUD with copies of the report. We will also provide copies to the Senate and House Committees on Appropriations and Government Operations.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script that reads "James B. Stacks". The signature is written in dark ink and is positioned above the printed name.

Comptroller General
of the United States

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ABBREVIATIONS

CDA	city demonstration agency
CPA	certified public accountant
EDC	Economic Development Corporation
FHA	Federal Housing Administration
HUD	Department of Housing and Urban Development
TMA	technical and management assistance
USI	Urban Systems, Incorporated

REVIEW OF CERTAIN ASPECTS OF THE GRAND RAPIDS,

MICHIGAN, MODEL CITIES PROGRAM

BACKGROUND

By letter dated February 27, 1973, Congressman Gerald R. Ford requested us to investigate the Model Cities Program in Grand Rapids, Michigan. During subsequent discussions with his office, we agreed to review certain activities of the Economic Development Corporation (EDC), contractor for the economic development project of the Grand Rapids Model Cities Program, and to obtain information on Freedom Homes, Inc., contractor for a home construction and rehabilitation project of the program. Mr. Ford gave us various documents containing charges of improprieties in EDC's handling of funds, which we agreed to review. The charges were categorized as

- questionable loan transactions,
- questionable grants and consultant contracts,
- conflicts of interest, and
- kickbacks of funds to obtain loans.

The Model Cities Program was established by title I of the Demonstration Cities and Metropolitan Development Act of 1966 (42 U.S.C. 3301). A local Model Cities Program consists of (1) a 5-year comprehensive demonstration plan describing the needs of the city in terms of projects required to make a substantial impact on social, economic, and physical problems of the city and (2) annual "action" plans which outline projects to be implemented each year. The Department of Housing and Urban Development (HUD)--responsible for administering the Model Cities Program at the Federal level--allocates funds to the cities for these plans.

The development and implementation of the Model Cities Program at the local level is the responsibility of a city demonstration agency (CDA) which, in Grand Rapids, is an administrative unit of the city. The Grand Rapids program was initiated in October 1970. As of June 30, 1973, CDA had incurred costs of about \$4.7 million.

Although CDA has local responsibility for the program, the various projects are usually contracted out.

EDC

CDA awarded a contract on July 27, 1971, to EDC--a private, nonprofit corporation--to develop, assist, and coordinate economic efforts and improve the economic base of the Grand Rapids Model Neighborhood citizens and area. Specifically, EDC's major objectives--stated in its first action-year contract and carried over to its second-year contract--were to

- provide residents with a source of investment capital, expert business assistance, and management training,
- coordinate business development programs in the Model Neighborhood area,
- create plans for new investment in the Model Neighborhood area,
- increase resident ownership and employment in Model Neighborhood businesses, and
- provide consumer education.

EDC received and used funds through the second action year ended December 31, 1972, as follows

Source of funds	
Model Cities grants	\$630,857
Interest from loans and repayment of principal	<u>16,465</u>
Total	<u>\$647,322</u>
Application of funds	
Loans	\$221,006
Grants and contracts for special projects	53,433
Contracts for profes- sional consulting services	151,576
Operating costs	217,092
Excess receipts over disbursements	<u>4,215</u>
Total	<u>\$647,322</u>

In July 1973 CDA approved a third action-year contract with EDC amounting to \$544,000 for January 1, 1973, through June 30, 1974.

In analyzing EDC activities, we reviewed loans, expenditures for professional and consultant services, special projects, and other administrative items. We also analyzed results of (1) reviews by the HUD Office of Audit and a firm of certified public accountants (CPA) engaged by CDA and (2) CDA evaluations. (See p. 22.) The detailed results of our review of EDC's activities are discussed in the following sections.

Questionable loan transactions

One of EDC's major objectives is to provide a source of investment capital to businesses and residents of the Model Neighborhood area. The resources to accomplish this objective were provided through three funds

--Seed Money Revolving Trust Fund--to be used only for loans on projects requiring additional funding from public and/or private business development sources. Funds were to be used for projects in the Model Neighborhood area or for projects employing Model Neighborhood citizens.

--Discretionary Revolving Trust Fund--to be used to finance projects, special studies, or research projects and to make low-interest loans to Model Neighborhood area businessmen when funds from other sources were not available.

--Special Projects Fund--to be used for business development ventures relating to youths aged 13 to 21.

During the first 2 action years (a 17-month period), EDC made 29 loans totaling about \$221,000 and guaranteed 2 bank loans totaling \$3,021. Additional amounts provided under these loans after January 1, 1973, brought the total loans as of May 31, 1973, to about \$250,000. Their status as of May 31, 1973, follows.

<u>Status</u>	<u>Loans</u>	<u>Loan amount</u>	<u>Loan balance</u>
Paid in full	1	\$ 600	-
Payments current	7	118,792	\$ 95,253
Payments delinquent			
2 months or less	5	22,772	20,535
Over 2 months	<u>16</u>	<u>108,209</u>	<u>104,928</u>
Total	<u>29</u>	<u>\$250,373</u>	<u>\$220,716</u>

In addition, payments were delinquent on the guaranteed loans as of May 31, 1973.

EDC has taken action on several of the delinquent loans. For example

--It is taking legal action to recover \$17,316 outstanding on 3 of the 16 loans delinquent over 2 months and \$1,004 on 1 of the 2 delinquent guaranteed loans.

--We were informed that legal action has been initiated on the remaining guaranteed loan--for which it has a \$2,017 liability--to secure from the loan recipient the musical instruments acquired with the loan funds and pledged as collateral for the loan.

--One recipient with a loan balance of \$5,798 has gone through bankruptcy proceedings. According to EDC officials, EDC will write off this amount.

EDC's Executive Director informed us that as of July 23, 1973, EDC had no plans to take legal action on the remaining delinquent loans.

Our review primarily evaluated the charges relating to certain loans. As agreed with Congressman Ford's office, we also reviewed a limited number of loans not related to the charges to determine whether EDC was complying with its loan guidelines. We analyzed EDC loan files and certain loan recipient records and discussed pertinent matters with EDC officials and the loan recipients.

The results of our review of individual charges are discussed below.

CHARGE--EDC granted Mrs. Thelma Frakes a loan insufficient to meet the financial needs of her business. In addition, EDC required Mrs. Frakes to sign two security agreements.

EDC loaned Mrs. Frakes \$5,825 as partial financing for a restaurant without obtaining assurance that the remainder of her financial needs--\$6,802--could be obtained through a bank and/or the Small Business Administration. Mrs. Frakes was unable to obtain the additional financing needed, and her business failed after 7 months. EDC's Executive Director stated that Mrs. Frakes' business failed because it was undercapitalized and that EDC acted prematurely in approving her loan without first obtaining assurance that additional financing could be obtained. As of May 31, 1973, Mrs. Frakes had repaid \$291 but was 6 months delinquent in her payments.

EDC did require Mrs. Frakes to sign two security agreements. The purpose of the second agreement was to list, by serial number, specific items of equipment used as collateral because the first security agreement did not contain such a complete list of the collateral.

CHARGE--EDC made loans to two musical groups--the Patterns and the Mississippi River--and a painter--Ed Wilson & Sons--that were questionable because the residences or places of business cited in the loan applications appeared to be unoccupied or occupied by other than the loan recipients.

EDC loaned \$1,100 to the Patterns to finance a tour. As of May 31, 1973, the group had repaid \$228 and was, according to EDC records, 3 months delinquent in its repayments. On August 27, 1973, however, EDC told us that the Patterns would be given credit for musical performances at EDC events in the Model Cities area and that this credit would, in effect, bring them up to date on their payments.

EDC's loan guidelines provide that before a loan is approved, EDC is to evaluate the potential recipient's ability to repay by obtaining and analyzing information on his projected income. We noted, however, that EDC did not adhere to these guidelines when it approved the loan to the Patterns.

Mr. Champion, EDC's Executive Director, stated that the address shown on the Patterns' application apparently was accurate, as he recently corresponded with them using that address. On July 31, 1973, we contacted a member of the Patterns at that address.

Although EDC initially approved a loan of \$2,017 to the Mississippi River group for purchasing musical equipment, the group subsequently obtained an EDC-guaranteed loan through a local bank. The group defaulted on the bank loan, and as of May 31, 1973, EDC had paid the bank \$188 under its loan guarantee. At the time of our review, EDC was attempting to repossess the group's musical instruments.

EDC's loan files indicated that before guaranteeing the loan EDC obtained information to show that the group had a

contract to entertain for an indefinite time at \$140 a week. Loan payments are \$94 a month. Also, EDC had a copy of a note and security agreement between the group and the bank on which the musical instruments were listed as collateral.

The leader of the Mississippi River group, Glen Gray (whose address was used on the loan documents), subsequently moved. However, Mr. Champion stated that he has contacted him about repaying the loan. In addition, EDC has the names and addresses of the other members of the group. On August 27, 1973, Mr. Champion advised us that legal action had been initiated to secure from the group the collateral for the loan.

On April 5, 1972, EDC loaned Ed Wilson \$5,421 to finance his painting and decorating business. Wilson, however, had not made any payments on the loan as of May 31, 1973, and, at that time, was 13 months delinquent in his payments.

Our review indicated that before approving the loan EDC obtained data on the financial feasibility of Wilson's business and how the loan proceeds would be used. During our review, we visited the address given by Wilson in his loan application and found it unoccupied. We were unable to locate Wilson to determine why he had not made any payments on his loan or to ascertain his views as to why the business venture apparently failed. EDC subsequently contacted him in connection with the legal action it was taking to obtain repayment of the loan.

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Our review of other loans disclosed one outside of the scope of EDC's program. In April 1972 EDC loaned \$600 to an individual to pay his tuition at a local college. Although recognizing that this loan was improper, an EDC official stated that it was approved for humanitarian reasons. The loan has been repaid in full.

In addition to using the revolving trust funds to make loans to businesses, EDC was authorized to use these funds to develop projects. The charges relating to one of these projects and our evaluation follow.

CHARGE--EDC improperly used loan funds to establish the Multi-Plex Development Corporation to purchase an interest in local businesses. In addition, there was a question as to what happened to the difference (\$6,000) between the \$15,900 purchase price for the Varsity Grill and the \$21,900 received from EDC for this purchase.

In March 1972 EDC did establish the Multi-Plex Development Corporation--a wholly owned profit corporation--to purchase an interest in local businesses. EDC considered this a desirable means for perpetuating and expanding business development after the conclusion of the Model Cities Program. Multi-Plex received \$71,900 from EDC--\$50,000 from the Discretionary Revolving Trust Fund in May 1972 and \$21,900 from the Seed Money Revolving Trust Fund in July 1972. With these funds, Multi-Plex purchased the Varsity Grill and a 51-percent interest in the Grand Rapids Times weekly newspaper.

According to HUD guidelines, a profit corporation may be established to acquire equity in individual businesses to stimulate economic growth, if a substantial number of Model Neighborhood residents own stock in the corporation and thereby control its operations. However, because Multi-Plex had not implemented its plan to sell stock to the residents, the city of Grand Rapids required EDC to give up its equity interest in the two businesses. To accomplish this, late in 1972 all of Multi-Plex's assets were transferred to EDC which, in turn, sold the Varsity Grill and converted its interest in the newspaper into a loan to the former owner.

Multi-Plex originally had an option to purchase the Varsity Grill for \$15,900 and a lot adjacent to it for \$6,000 for a total of \$21,900--the amount received from EDC. However, Multi-Plex purchased only the Varsity Grill. On October 10, 1972, while EDC was assuming the assets of Multi-Plex, the \$6,000 for the purchase of the vacant lot was returned to EDC by Multi-Plex.

Questionable grants and consultant contracts

In addition to providing a source of investment capital through the revolving funds, EDC was authorized to award contracts to third parties and fund special projects to accomplish its objectives, such as

- providing expert business assistance and management training,
- coordinating business development programs, and
- providing consumer education.

As of December 31, 1972, EDC had awarded 13 contracts and had spent about \$192,000 under them. In addition, EDC spent about \$12,000 on three special projects.

We reviewed the award and administration of contracts and special projects for which there were charges of improprieties. We also reviewed contracts on which there were no such charges to determine whether any problems existed. We evaluated contracting procedures used by EDC, analyzed contractor records; evaluated services provided, when possible, and discussed such matters with EDC, CDA, and contractor officials.

The charges and the results of our analysis follow.

CHARGE--EDC paid between \$2,700 and \$3,700 to Mrs. Patricia Mathis to conduct business training seminars, even though she did not have any special training or experience. Further, EDC did not terminate or change Mrs. Mathis' contract despite the disappointing attendance at her classes.

Our analysis did not disclose any information to question Mrs. Mathis' qualifications to teach a course in record-keeping and business management. However, we found that the Grand Rapids school system offered a similar course for substantially less than the \$3,700 paid to Mrs. Mathis. For example, the school system could have provided the course for 10 students at a maximum cost of \$200.

As charged, Mrs. Mathis' classes had very limited attendance. Available records for 15 of her 20 classes showed that no one attended 10 and only 1 to 7 attended the other 5. The contract did not require Mrs. Mathis to guarantee a specific level of attendance at her classes and allowed EDC to terminate the contract only if Mrs. Mathis did not perform satisfactorily.

We discussed this matter with the CDA Director, who admitted that it would have been good business practice to include a provision in the contract whereby EDC could terminate or reduce payments to Mrs. Mathis under these conditions. He stated it was an administrative oversight on his part for not recommending such a provision before contract approval. The EDC Executive Director told us that future contracts will include proper controls.

CHARGE--EDC approved a contract or grant to Consultants and Counseling, Inc.--a nonexistent corporation--to prepare a directory of minority businesses. Also, EDC directly paid Mrs. Samson Gary rather than Consultants and Counseling, Inc.

On November 1, 1971, EDC awarded a \$9,448 contract to Grand Rapids Consultants and Counseling, Inc., which--contrary to the charge--was a registered Michigan corporation as of May 10, 1971. The contract, awarded 5 months after the company was incorporated, required the contractor to obtain information necessary to establish a management information system useful to the Model Cities Program. The corporation was not required to and did not prepare a minority business directory. EDC's records showed that payments were made directly to the corporation, not to Mrs. Gary, and that the corporation paid Mrs. Gary a weekly salary of \$150.

CHARGE--EDC paid Alphonse Lewis \$19,950 for legal services rendered during 1972 while he may have been suspended from professional practice because of a conviction of income tax evasion

According to Lewis, he billed EDC \$17,700 for legal services performed in 1972. However, EDC paid Lewis \$13,000--the maximum amount allowed for services provided

under his contracts for January 3, 1972, through December 31, 1972. According to the Michigan Bar Association, Lewis had been continually licensed to practice law in Michigan since at least January 1, 1971.

CHARGE--Rodella Horton, an EDC loan recipient, catered numerous luncheons for EDC and was paid by EDC for more meals than actually served.

According to both Rodella Horton and EDC's Executive Director, EDC had an informal agreement to pay for the number of meals ordered even though the number of guests attending the luncheons was less. Records were not available to determine the number of meals ordered or served. The records did show that she received about \$1,700 for catering meals in calendar year 1972.

CHARGE--EDC awarded noncompetitive contracts to Urban Systems, Inc. (USI) contrary to CDA regulations. Further, EDC paid USI substantial sums--possibly as much as \$120,000--for consulting services performed sloppily.

We found that EDC had noncompetitively awarded USI two contracts with a total value, as amended, of \$99,220. However, at the time--September 1971 and April 1972--CDA had not adopted its policy that contracts over \$1,000 should be awarded competitively. CDA did not adopt this policy until July 1972, and such contractors as EDC were not required to implement the policy until late 1972.

USI, a Maryland corporation, was organized in 1966 to provide research and consulting services to private and Governmental organizations involved in finding solutions to the social and economic problems of our cities.

EDC initially awarded a contract to USI in September 1971 to provide technical assistance in

--preparing and negotiating portions of the contract between EDC and CDA,

--planning and developing an orientation and procedures manual,

- preparing EDC's work program,
- establishing the initial economic development strategy,
- developing management and staff training programs,
- designing a management information system and consumer service program, and
- developing detailed guidelines for spending trust funds.

Under the contract, EDC paid USI \$20,833 for services provided which, according to EDC's Executive Director, were satisfactorily completed.

To evaluate the types of expenditures charged, we attempted to obtain USI's records relating to this contract from John Huffner, USI's president. However, Huffner advised us that these records were stored at his residence in the Washington, D.C., area. Huffner left Grand Rapids after closing his office on March 31, 1973. We contacted him at his residence in Maryland on June 7, 1973, and he agreed to give us the records on the first contract. However, Huffner failed to provide the records and we have been unable to contact him again.

Before leaving Grand Rapids, Huffner did furnish us records on the second contract awarded by EDC in April 1972. Under this contract, valued at \$77,378, USI was to design, organize, and administer a technical and management assistance (TMA) delivery system to support EDC-designated projects--loan recipients and other businesses.

According to our review of the services provided and the costs incurred by USI under the second contract

- USI did not provide the full range of services required by its contract and, as charged, those services provided were of poor quality.
- EDC paid USI without verifying whether the billed amounts under this cost-reimbursable contract represented actual costs incurred in performing the contract

The TMA system, as designed by USI, was to provide EDC loan recipients with a wide range of technical and management assistance needed to establish businesses and assist them in dealing with day-to-day operating problems. The broad design of the system called for "project managers" to work closely with businesses to determine their needs and then bring in specialists to provide the technical assistance needed.

Although a broad range of services was to be provided, a CDA evaluation report dated March 12, 1973, showed USI rarely performed more than bookkeeping service for most EDC loan recipients. According to 27 businesses polled by CDA evaluators, 17 had been given help with their bookkeeping and 7 had received assistance in advertising and promotion. According to the CDA evaluation, these businesses did not use the USI assistance in other management areas, primarily because they felt they knew more about managing their own businesses than the USI staff did.

In evaluating the quality of the USI services, we reviewed the accounting records of several businesses whose records were maintained by USI personnel. We found that they contained numerous weaknesses, including the following, in applying generally accepted accounting practices.

- Improper computation of owners' capital and depreciation accounts.
- Erroneous journal entries.
- Improperly stated asset and liability accounts.
- Numerous computation errors.

In addition, EDC personnel stated that for loan recipients served, USI had not

- provided EDC with required profit-and-loss statements on a timely basis,
- prepared records in accordance with EDC guidelines, and
- closed books at the end of the year, thus requiring the EDC accountant to perform this function.

In commenting on the quality of services provided, Huffner stated that his employees made many mistakes because they came from the Model Cities Neighborhood and had little experience in providing TMA services. He stated that he believed his employees' identification with the area and with businessmen were important factors which offset the disadvantage of being unskilled.

Under its second contract, USI was to maintain accounting and expense records to document and support all costs incurred. Requests for payment to EDC under the contract were to be submitted for actual costs incurred. Mr Huffner stated that USI's requests to EDC for payment were based on the EDC Executive Director's advice as to the amount EDC had available to pay USI rather than on the basis of costs incurred. The Executive Director stated that he had not asked for data to support the costs incurred because no one at CDA had asked for it and he assumed USI had such data on file at its office, as required by its contract.

Our review of USI records showed certain accounting records had not been posted since August 1972, and at the time of our review invoices were unavailable to support all the transactions in the records. As a result, we were unable to verify all the costs incurred by USI under the contract

However, our review did show several questionable transactions, as follows

- USI received a \$15,000 check from EDC, however, Huffner deposited \$13,900 in USI's bank account. In tracing the disposition of the remaining \$1,100, we found it had been recorded in USI's books as expenditures for travel and supplies. Huffner advised us that the \$1,100 was not deposited because he used it to pay personal expenses. He stated the entries in USI's books were in error and that the amount should have been charged to his salary account
- USI deducted Federal income tax from its employees' salaries but did not deposit the money to the credit of the Government. Huffner stated USI owes over \$5,000 in back taxes because it did not have sufficient funds to make the payments. We referred this

matter to the Detroit District Office of the Internal Revenue Service. The Detroit Office was unable to locate Huffner in Michigan and on June 29, 1973, requested their Baltimore District Office to pursue the matter further since Huffner apparently lives in Brinklow, Maryland.

- USI purchased and recorded as an asset of the corporation a motorcycle costing \$1,600 for the personal use of Huffner. Huffner agreed the transaction was recorded incorrectly. He stated the purchase price should have been charged to his salary account.
- USI loaned \$444 to an EDC board member. Huffner stated he made the loan as a personal favor and had not received repayment as of May 7, 1973. This appears to be an ineligible cost for reimbursement under the contract.

Huffner agreed that records supporting expenditures under this TMA contract were poor. He stated that he was unaware of their condition until he examined the books in January 1973 (USI's records were maintained by an accountant on his staff.) Huffner also stated that he had worked more hours than he had been paid for under the contract and that entries in his books would support this. His records showed about \$8,900 was due him for hours worked from inception of the contract in April 1972 through August 1972 and that he had been paid about \$6,000 for his services for the period. However, his records showed no entries of hours worked to support payments of \$6,400 from September through December 1972.

According to EDC records, EDC still owes USI \$4,900 under this contract. EDC's Executive Director stated on July 23, 1973, that before making final payment EDC will thoroughly review USI's records to insure that all costs are properly supported and allowable under terms of the contract. He specifically stated that he would disallow reimbursement of the \$444 loan to an EDC Board member.

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We identified two other instances where contracts were awarded for services that could have been obtained free or at less cost from other sources. In addition, one of the

contracts was for services outside the scope of EDA's objectives.

EDC awarded a contract for \$3,700 to provide Model Neighborhood businessmen instructions and materials to inscribe an identifying mark on their equipment so that it could be identified if stolen. This service could have been obtained free from the Independent Insurance Agents of Grand Rapids. EDC's Executive Director, Mr. Champion, stated that, although he was aware of the free service, he favored award of the contract because the service would be taken to the businesses rather than the businesses having to take the initiative to obtain the services.

EDC also awarded a contract for \$5,500 to a community center to purchase typewriters and teach typewriter repair and related skills. The center, however, did not teach the course in typewriter repair because after the award of the contract the center determined that the Grand Rapids area had little or no demand for typewriter repairmen. Instead, since typewriters had been purchased, the center taught typing courses. We found that the Grand Rapids school system taught such courses at little or no cost. In our opinion, such training would more appropriately be sponsored by the Model Cities Comprehensive Manpower Program--responsible for providing job assistance and training to Model Neighborhood residents.

Mr. Champion stated that a typewriter repair course would have been within the scope of EDC's objectives, since it would have prepared individuals to go into the typewriter repair business. However, he stated that after the contract was awarded, the decision to go ahead with the typing course--which was outside the scope of EDC's objectives--was made to make use of the typewriters.

Conflicts of interest

Under conflict-of-interest provisions incorporated in EDC's contracts, members of EDC, CDA, and the city's governing bodies or their employees are not allowed to receive any benefit, directly or indirectly, from the contracts. Neither are they allowed to own or acquire any personal interest in any property, contract, or proposed contract which would conflict with the performance of their duties. Any interest on the part of EDC or its employees must be disclosed to CDA. The contract provides, however, that the conflict-of-interest provisions shall be interpreted so as not to impede the statutory requirement that maximum opportunity be provided for employment of and participation by residents of the Model Neighborhood area. HUD guidelines require CDA to take appropriate action to insure compliance.

Seven conflict-of-interest situations related to EDC's activities were alleged. EDC's Executive Director stated that, although he did not formally ask for CDA's opinion on whether the situations constituted conflicts of interest, he had discussed most of the instances with the CDA Director.

CDA's Director stated he was aware of the possible conflict-of-interest situations. Further, he stated the cases were not referred to the city attorney or HUD for a legal determination because he had determined that they were not contrary to the public interest. He stated that he had discussed several of the situations with the HUD official responsible for administering the Grand Rapids Model Cities Program and that the HUD official concurred with his position.

We discussed the possible conflicts with a HUD official who advised us that the CDA Director followed the normal procedure for resolving possible conflict-of-interest situations. She stated that CDA is responsible for insuring that the Model Cities Program is administered according to HUD and city guidelines and that HUD does not require possible conflict-of-interest situations to be submitted to it for legal determinations. She also stated that she concurred with the city attorney's opinions we requested regarding the cases described below.

On July 23, 1973, we requested an opinion from the Grand Rapids city attorney on situations which were charged

to be conflicts of interest. The charges, the facts concerning each situation, and the city attorney's opinions follow.

CHARGE--EDC Board members served as members of the Board of Directors of the Multi-Plex Development Corporation, a wholly owned subsidiary of EDC.

Although EDC Board members had served in the dual capacity, as charged, the Grand Rapids city attorney concluded that this did not constitute a conflict of interest since EDC wholly owned Multi-Plex. He stated that interlocking directorships between a parent company and a subsidiary are common and do not create conflict situations. Multi-Plex--no longer a functioning organization--was required by the city to return all its assets to EDC. (See p 8)

CHARGE--Mr Champion, EDC's Executive Director, was affiliated with Action Unlimited, an EDC contractor.

CDA awarded a contract to EDC on July 27, 1971. In accordance with HUD guidelines, Champion resigned from Action Unlimited on August 1, 1971, to avoid any conflict of interest.

CHARGE--EDC awarded a \$3,700 contract to Mrs. Patricia Mathis, the wife of EDC's accountant, to teach a course in recordkeeping and business management.

As charged, this contract was awarded to the wife of an EDC staff member, Mr Mathis. However, the Grand Rapids city attorney stated that neither HUD nor city conflict-of-interest provisions were violated by awarding contracts to relatives of staff members who have no control over contractual matters. The attorney also stated that the most this would represent is nepotism, which is not illegal. Services under this contract were completed, and final payment was made by EDC in late 1972.

CHARGE--Under an EDC contract with the Grand Rapids Consultants and Counseling, Inc , Mrs Ledora Gary, wife of EDC's business analyst, was employed as project director

Mrs Gary was employed as the project director. However, as in the case above, the Grand Rapids city attorney stated

that neither HUD nor city conflict-of-interest provisions preclude awarding contracts to relatives of staff members if the staff members have no responsibility for administering contracts. Services under this \$9,448 contract were completed in May 1972.

CHARGE--Several people in responsible positions--Samson Gary, EDC's business analyst; Alphonse Lewis, under contract to EDC for legal services, and Wilbur Warren, board member of the Model Neighborhood Citizen Committee--were on the board of directors of Telecommunications Actions Committee when it received a grant of \$2,665 from EDC.

The above-named individuals were involved with both organizations. Gary subsequently resigned from the Telecommunications Actions Committee--a nonprofit corporation whose purpose is to encourage radio and television industries to become constructively involved in meeting the communications needs of minorities. As of July 1973 the other individuals were still affiliated with both organizations. Of the \$2,665 received, the Committee's expenditures as of June 15, 1973, were \$1,380 for administrative costs and reimbursement of some travel expenses.

The Grand Rapids city attorney stated that, since the Committee was a nonprofit organization and the individuals involved received no salary, this would not constitute a conflict of interest under HUD or city guidelines.

CHARGE--EDC's Executive Director is affiliated with the Small Business League which is renting office space to EDC for \$650 per month.

The Executive Director of EDC is President of the Small Business League, and EDC does rent space from that nonprofit corporation. In May 1973 EDC was paying \$400 a month rent to the League. The CPA firm engaged by CDA found that the rent paid by EDC was reasonable for the space occupied. The Grand Rapids city attorney stated that, since the League was a nonprofit organization with goals similar to EDC's and since the rent paid was reasonable, HUD and city conflict-of-interest provisions were not violated.

CHARGE--Rodella Horton--a business associate of EDC's Executive Director, Mr. Champion--received an EDC loan.

EDC did loan \$13,354 to Rodella Horton in March 1972. Although Miss Horton's records were incomplete, we were informed that she used the loan proceeds for (1) payment of outstanding debts, (2) a downpayment on some business property, and (3) working capital.

She is a business associate of Champion, as she is on the board of directors of the Small Business League, of which Champion is President. In addition, she holds a real estate license under Champion Real Estate, owned by Champion. Miss Horton did not become a League board member until May 1972--3 months after receiving her loan--and her real estate license was not transferred to Champion Real Estate until August 1972--5 months after receiving her loan. The Grand Rapids city attorney stated that, under the circumstances, neither HUD nor city conflict-of-interest provisions were violated by this loan.

Kickbacks

Our review of the three specific charges did not disclose any kickbacks. When possible, we analyzed receipts and disbursements of selected businesses, reviewed and compared checks written by EDC to the accounting records of various loan recipients, and discussed with loan recipients the possibility of kickbacks. To determine whether any potential kickback situations, other than the three charged, existed, we also reviewed loan application files and talked to applicants who had not received loans. We found no evidence that any kickbacks had occurred.

The specific charges and the results of our review follow.

CHARGE--Jerry Conaty claimed that in April 1971 he gave Lessley Fisher \$5,000 to give to Champion in return for a loan from EDC. Also, Conaty charged that five other individuals were to receive kickbacks when the money from the loan was received

During discussions with Conaty, we were informed that the alleged \$5,000 cash payment was made to Fisher to be given to Champion in return for a loan. Conaty also stated that

Fisher had repaid him \$2,700 in cash. However, both Fisher and Champion stated that there was no truth to Conaty's charge. Because documentation was lacking, we were unable to determine whether the alleged \$5,000 payment had actually been made to obtain a loan from EDC. We noted, however, that as of July 23, 1973, neither Conaty nor Fisher had received a loan from EDC.

CHARGE--A member of EDC's loan review committee told Luther Von Miller his loan would be approved if he gave her a table and two chairs.

In November 1972 Von Miller requested the EDC loan review committee to approve a loan for about \$36,000 to expand his furniture manufacturing business. The committee, after discussing Von Miller's proposal, requested the EDC staff to obtain additional information. Von Miller informed us that the charge concerning the gift of a table and two chairs to obtain a loan misrepresented the facts. He stated that for promotional purposes he offered to sell, at a discount, furniture which he manufactured to several Grand Rapids citizens, including an EDC board member. In retrospect, Von Miller believed he should not have offered his furniture for sale to such people because his intentions could have been misinterpreted. As of July 23, 1973, Von Miller had not received a loan from EDC.

CHARGE--EDC's Executive Director told Silas Deans that he could obtain a larger loan if he would make EDC a partner in his business.

EDC's Executive Director told us that neither he nor anyone at EDC had made such a statement to Deans. Deans applied to EDC for a loan of \$75,000 to start a business of making and distributing posters. EDC's Business Research Analyst told us that EDC approved a loan for \$9,930 because (1) Deans could not support the need for the proposed \$75,000 loan, (2) Deans had only limited collateral to secure the loan, and (3) a single loan of \$75,000 would have rapidly depleted EDC's loan funds. As of May 31, 1973, Deans was 8 months delinquent in his loan payments. EDC took legal action to recover the balance due from him in December 1972. Deans was incarcerated because of another matter at the time of our review, and, as agreed with Congressman Ford's office, we did not attempt to contact him for clarification or any additional details on this charge.

Prior reviews of EDC

The HUD Office of Audit reviewed the Grand Rapids Model Cities Program for the 3 years ended September 30, 1972. The HUD audit concentrated on evaluating CDA activities and operations. At the request of CDA, a CPA firm reviewed EDC's financial transactions for June 17 through December 31, 1971, and for the year ended December 31, 1972. CDA also evaluated EDC operations for both the first and second action years.

Audits by CPA firm

The CPA firm's February 24, 1972, report on EDC's financial condition as of December 31, 1971, stated that all costs incurred by EDC were eligible and in accordance with contractual terms. The report pointed out that some of EDC's accounting procedures generally failed to comply with HUD regulations. The auditors noted that at the completion of their review some corrective action had been taken and the problems with the remaining accounting procedures could be readily resolved.

The auditors' report covering EDC's financial condition as of December 31, 1972, was issued on March 14, 1973. Although stating that EDC's accounting policies and procedures substantially met all HUD requirements, the auditors

- questioned the propriety of using loan funds for purposes other than granting loans,
- made observations concerning possible conflicts of interest,
- suggested EDC try to reduce travel costs, and
- recommended advertising be done on a planned, selective basis.

The auditors mentioned three possible conflict-of-interest situations in their report which are also discussed in our report. In summary, the auditors stated

"Some of the projects undertaken, because of the costs involved, have seriously impaired the Agency's [EDC's] ability to grant loans to neighborhood businesses. The [EDC] Board should be encouraged to establish priorities for the use of available funds and systematically develop a program that will maximize benefits to those for whom the entire program was initiated."

CDA evaluations

CDA's first-year evaluation report of EDC's activities was dated June 20, 1972. In this report, the CDA Evaluation Task Force concluded

- too many of the loan recipients were non-Model Neighborhood residents,
- too many of the businesses assisted by loans were located outside the Model Neighborhood area,
- the type and amount of technical assistance given to businesses needed to be reevaluated, and
- loan procedures needed to be shortened and made more flexible.

Its second-year evaluation report, dated March 12, 1973, pointed out that EDC committed a major part of its three funds to a series of transactions which strained the guidelines established for the use of these funds, including

- loaning money to non-Model Neighborhood residents or to businesses outside the Model Neighborhood area and
- financing contracts for professional services, consumer services, and other projects.

The report concluded that resources which could have been available for loans were put to other uses and spent in ways which would not return the resources to the revolving funds.

EDC officials' comments

Mr. Champion stated that actions had been or would be taken to overcome problems identified as a result of evaluations of EDC activities. He stated that EDC's third action-year contract had been revised to specifically limit the use of loan funds for anything but loans and business development activities.

Under business development activities, the contract allows up to \$40,000 to be used for market analysis and feasibility studies for large commercial and industrial ventures. Also, under the contract EDC will be required to develop new loan guidelines establishing preference criteria for using loan funds, including insuring that Model Neighborhood residents and businesses are given preference on loans. The guidelines require also that EDC act on loan applications within 30 days after receipt.

Mr. Champion stated that most technical assistance given to businessmen will be provided by EDC staff rather than under consultant contracts, as previously done. Mr. Champion stated also that the CDA policies and procedures manual now requires advance CDA approval for certain travel and that he is reevaluating and revising EDC's advertising policy.

Conclusions

Our review disclosed several problems in EDC's administration of the Grand Rapids Model Cities economic development project and confirmed the validity of certain aspects of charges made against EDC. Additional questions were raised concerning EDC's operations in reports on reviews made by other review groups.

On May 23, 1973, as requested by Congressman Ford's office, we briefed the mayor of Grand Rapids on the results of our review. The city manager also attended this briefing, at which we pointed out that many of the problems with EDC's loan and contracting practices had previously been reported to the city in CDA's evaluation report and in the CPA firm's report on its financial audit of EDC. We stated that the reports contained many recommendations which should be carefully considered in arriving at EDC's third action-year

contract. The mayor stated that he would fully consider our findings and the recommendations in the other reports. After we completed our fieldwork, the city awarded EDC a third action-year contract for \$544,000. According to the CDA Director, provisions of this contract, and a closer monitoring of EDC activities by CDA, should preclude many of the past problems. For instance, he stated that the contract language on use of loan funds is much more specific and that other actions were being taken, such as training the EDC staff and loan review committee and requiring EDC to obtain CDA approval before incurring travel costs in some instances. He added that the contract allows greater city involvement earlier in EDC's decisionmaking process.

Recommendation to the Secretary of
Housing and Urban Development

We recommend that HUD follow up to evaluate the adequacy of the actions taken by CDA and EDC to correct the problems noted in EDC's administration of the economic development project.

FREEDOM HOMES, INC.

CDA awarded Freedom Homes, Inc , a contract in March 1971--with maximum allowable expenditures of \$125,000--to improve housing in the Model Neighborhood. The major objectives of the Freedom Homes project during its first action year were to

- construct at least 20 new single-family homes,
- rehabilitate for sale at least 24 homes, and
- provide employment and on-the-job training for at least 6 Model Neighborhood residents.

The city subsequently awarded Freedom Homes a contract for the second action year--January 1, 1972, through December 31, 1972--with maximum allowable expenditures of \$187,000. The contract period was later extended through February 28, 1973. Under the second-year contract, Freedom Homes was to construct at least 50 homes, rehabilitate at least 50 homes, and employ and train at least 12 Model Neighborhood residents.

According to CDA records, Freedom Homes had spent \$193,300 as of June 13, 1973, under the two contracts, as follows

Salaries	\$ 84,550
Administrative expenses	45,200
Construction expenses	<u>63,550</u>
Total	<u>\$193,300</u>

The CDA Director advised us that the city did not award Freedom Homes a contract for the third action year because it believed Freedom Homes had not satisfactorily achieved its objectives under the first two contracts.

Our review of the activities of Freedom Homes was limited to examining CDA's files and evaluation reports and discussing them with CDA officials. In April 1973 we requested CDA to obtain Freedom Homes' records--reportedly held by the Chairman of Freedom Homes. However, as of June 14, 1973, CDA was unable to obtain these records.

CDA evaluation of Freedom Homes, Inc.

The CDA Evaluation Task Force report on Freedom Homes, issued in January 1973, pointed out that, as of December 1972, Freedom Homes had not built or rehabilitated any homes, although it had begun construction on two new homes during December. The report cited two major reasons for this lack of activity

--CDA did not release money for the revolving funds until November 1972 because Freedom Homes did not have an adequate accounting system.

--Freedom Homes did not take the basic steps necessary to get a construction program underway.

Adequacy of accounting systems

Before CDA awarded the first action-year contract, a CPA firm evaluated Freedom Homes' accounting, reporting, and internal control systems to determine whether they met city and HUD requirements. In a December 18, 1970, letter to CDA, the firm reported that Freedom Homes' systems and procedures did not comply with HUD regulations and made specific recommendations on the changes needed.

In March 1971--when the first action-year contract was awarded--CDA instructed Freedom Homes to implement the CPA firm's recommendations to improve its financial control system. In July 1971 Freedom Homes submitted to CDA proposed guidelines for using construction and rehabilitation funds. These guidelines were approved by the city in November 1971 and by HUD in mid-December 1971.

In December 1971 Freedom Homes requested an advance of funds from CDA to begin construction and rehabilitation. However, before releasing any money for these purposes, CDA requested Freedom Homes to insure that its fiscal control system met HUD standards. In January 1972 Freedom Homes wrote to CDA describing the improvements in its system.

Subsequently, CDA asked the CPA firm to certify that Freedom Homes' accounting system now met HUD requirements. The CPA firm, however, could not certify the system because essential bookkeeping had not been done for 6 months

Freedom Homes did not finish updating its accounting records and implementing the recommended improvements in the fiscal control system until October 1972. The CPA firm subsequently certified the system as complying with HUD regulations. CDA released funds to Freedom Homes on November 28, 1972--20 months after awarding the first contract--and construction was started on two homes in December 1972. As of September 14, 1973, the two homes had been completed by CDA and were available for sale for \$17,500 and \$18,000.

Mortgage financing

One of the more important tasks preliminary to construction or rehabilitation was to obtain a Federal Housing Administration (FHA) commitment to insure the full amount of the mortgages for the proposed units. Freedom Homes did not contact FHA until August 1972. FHA would not make a commitment to insure the full amount of the mortgages for the proposed homes because the value of the needed mortgages substantially exceeded the market value of the homes in the neighborhood. This problem was substantially overcome when CDA obtained an FHA commitment to insure the mortgages for up to \$17,500 for each home. CDA agreed to use its funds to underwrite the difference between the amounts insured by FHA and the selling price of the homes.

CDA Director's comments

The CDA Director stated that he continued funding Freedom Homes through February 1973 because enough progress was being made or promised to justify a certain amount of optimism. He stated that he had believed that, given additional time, the contractor would accomplish some tangible benefits. However, he later concluded that the program would have to be re-evaluated and a new contractor found if any benefits were to be derived.