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Office of Homeless Services, Budget Deficit	Administrative – Dept. Inspection	☒ Preliminary ☐ Final

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CITY OF PHILADELPHIA
OFFICE OF THE INSPECTOR GENERAL

Report of Investigation
Office of Homeless Services

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Date of Report:
April 22, 2024

I. Overview

During FY24, in connection with the mid-year transfer process, the Office of Homeless Services (OHS) reported a "budget deficit" of approximately $15 million.[1] Although the office's operating costs had well exceeded the budgeted appropriation for at least two years prior, the scope of the shortage was never fully transparent. As such, the matter was referred to the Office of Inspector General (OIG) for further investigation.

The OIG offers this report in an effort to *(i)* illustrate the operating environment that caused the deficit and *(ii)* clarify the nature of the department's past financial transactions, so that the City can move forward with the FY25 budget process from a more informed position and with more robust internal controls.[2]

The following information was assembled from employee testimony and compelled production of documents, as referenced within the text. Later sections also include a series of illustrations to aid understanding of the transactions and their implications.[3] Sections II, III and IV present narrative background about the agency, its leadership, culture and general treatment of the deficit. Section V outlines the four basic contract conformance and payment tools that the department employed to carry and manage the debt. Section VI presents some additional complexities with limited discussion[4] and Section V concludes with the OIG's analysis and five internal control recommendations.

II. Leadership & Operating Environment

At the outset, it is important to offer the operational context that existed within OHS under the leadership of Executive Director Liz Hersh (Hersh) – who served as the office's chief executive from 2016 through the summer of 2023. All of the parties interviewed in connection with this investigation painted a fairly consistent picture of Hersh's management style, priorities and general command of the department's budget and financial health.

Overall, her colleagues described her as a dominant figure who wielded strong executive authority over the people and programs within OHS. Hersh was reportedly quite committed to the homeless population and personally driven by the department's mission, although she was disinterested in the minutia of the OHS budget and/or the specific fiscal management of the large catalog of services contracts.

Those who worked under Hersh described her as uniquely focused on meeting the needs of the City's homeless population – highlighting "service level" over-and-above most other considerations.

[1] The department's financial status has been described in a number of different ways, including a "budget deficit" and an "overspend." Technically, as explained in later sections, OHS spent the appropriations *and* entered into debt in the form of contractual commitments that exceeded the budget. The recent $9.6 million General Fund adjustment was to resolve that debt.

[2] Note that this report is preliminary. A number of investigative questions remain, including, the scope of individual accountability, possible criminal or civil implications for fraud or misrepresentations, and the potential impact of these departmental practices on federal- and/or state-sponsored grant funding as well as the City's broader budget process.

[3] These illustrations are structural representations that do not track specific OHS transactions.

[4] In many ways, this report presents an overly simple picture of the OHS financial activity in order to offer clarity. Later sections present the basic concepts that were amplified by some additional technical factors referenced in Section VI.

Understanding that the primary function of OHS was to operate the shelters and other housing support services[5] for those in need, Hersh was keenly focused on ensuring that those facilities and programs could service a large, and potentially increasing, volume. To Hersh, cutting services for the homeless was never an option.[6]

Moreover, Hersh often cited the need to support the various housing providers and the employees who worked there, reasoning that these facilities were typically small, underfunded non-profits that were mostly staffed by individuals who had housing challenges themselves. The need to get the vendors paid, therefore, was also a central concern within OHS that drove much of the financial activity.

Her colleagues conversationally described Hersh's general day-to-day calculus as somewhat reversed – asking things like, "We have a need, how do we meet it?" rather than, "How can we best meet the need using the resources we have?" Hersh herself confirmed this general approach – she was very squarely focused on substantive services and the critical needs of the homeless. These priorities saturated the professional culture at OHS, and the operating environment became one of heightened emergencies that necessitated immediate agency action in potentially life-or-death circumstances. Departmental spending, of course, followed.

During the first years of Hersh's tenure, with relative capacity and stability in the OHS budget,[7] this leadership approach was functional and unchallenged. But the pandemic, of course, introduced significant volatility in the OHS funding level from year-to-year, in addition to a much deeper need for homeless services and supports. As such, the department began its course to acquire an ever-increasing amount of debt.

III. Pandemic Budget Cuts & ESG Funds

In FY21, OHS endured a significant cut in General Fund appropriations, roughly $17 million. During the budget process, this decrease was primarily assigned to Class 200 – the source of funding for the department's service contracts.[8] But during this first pandemic-era fiscal year, the reduction in local appropriation was largely offset by the CARES Act, which infused the department with approximately $35 million in Emergency Solutions Grant (ESG) funds that remained spendable through September 2023.[9]

As a matter of substantive services, the majority of the OHS contracts were, or would soon be, generally eligible for grant funding of some kind.[10] Even if some contracts had been previously fully funded with General Fund appropriations, with minimal administrative changes the department could fairly easily

[5] The programs that OHS administers are quite deep and varied. They include prevention, long-term housing solutions, emergency and temporary housing solutions, shelter operations and rapid re-housing, among others. Throughout this report, program activity is referenced generally for ease of understanding.

[6] During Hersh's tenure, programs were ceased, reduced or relocated for operational reasons. But there is no evidence of a service cut that was driven purely by budget considerations.

[7] Between FY16 and FY18, the OHS General Fund appropriation was roughly between $45 million to $48 million. Through FY19 and FY20, the agency's General Fund appropriation started to approach $60 million.

[8] According to the published FY21 budget, the department's General Fund appropriation was decreased by $16,874,922. Of that, $15,285,936 was assigned to Class 200.

[9] Aimed at services for the homeless, *see* https://www.hudexchange.info/programs/esg/esg-requirements/.

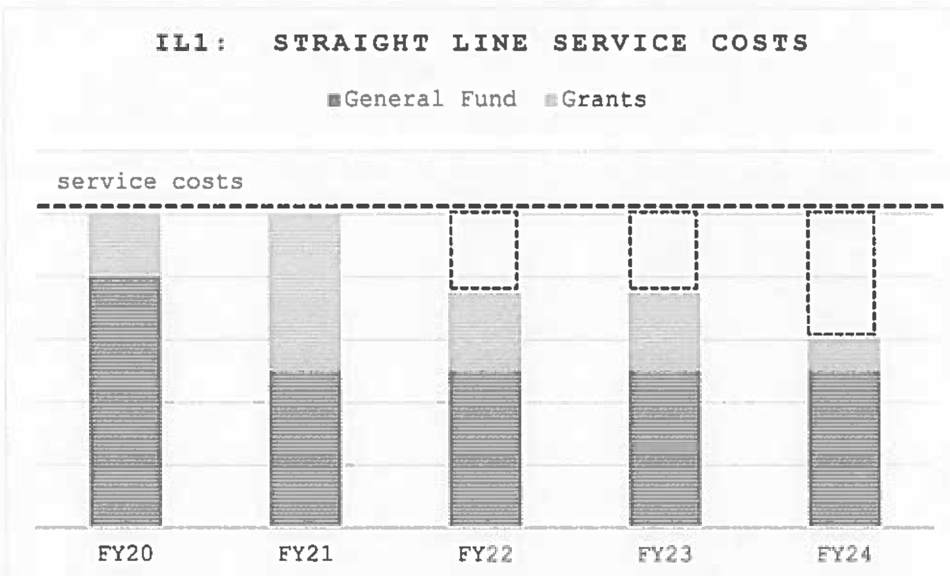
[10] Depending on the specific grant. ESG was the largest during this time period.

leverage the grant funds against the General Fund reduction. This allowed for much more flexibility in the funding of certain housing programs, using a mix of both General Funds and grants.[11]

The department's specific use of grant funding is discussed in greater depth below. But clearly this was only a short-term solution, as the ESG appropriation was a single, discrete subsidy that was not recurring and therefore could not sustain an ongoing obligation to the service providers from year-to-year.

The following year in FY22, a portion of the prior year's General Fund reduction was restored, but less than the full $17 million.[12] As such, the department was confronted with an estimated deficit of approximately $4 million in Class 200 General Funds. As time passed, and with a declining balance of available grant funds to offset, it soon became impossible for the department to maintain a consistent level of service without incurring serious debt in subsequent years.

Illustration 1, to the right, shows the basic problem.[13] As the department lost the ability to cover the shortage with available grants, without spending adjustments OHS was operating "in the red."



To Hersh, this $4 million gap in the FY22 budget dominated her understanding and discussion of the deficit moving forward. During her OIG interview, she described this inadequate restoration of the General Fund as a key inflection point and the core of the problem that the City now faces. Hersh was also clear that, despite this gap, the department did not respond with a corresponding service cut in FY22. Rather, in consultation with the Managing Director's Office (MDO), Hersh moved forward without adjustment believing that there would be some future opportunity to retroactively balance the budget – perhaps some future appropriation, another grant or some other interdepartmental cost-sharing mechanism.[14]

[11] Prior to the pandemic, the OHS contract catalog was largely, but not entirely, segregated by funding source. Notably, OHS also began some new programs with a portion of the ESG grant. These programs were later extended and supported by the General Fund as the ESG balance declined.
[12] The published FY21 budget shows a Class 200 decrease of $15,285,936. The published FY22 budget shows a Class 200 "Restoration" of $11,126,324. The difference is $4,159,612.
[13] This graph is for illustration only, it is not a scaled representation of the actual OHS deficit.
[14] At various points over the past few years, the MDO was aware of a budget need at OHS, but the depth of the issue was not clearly presented until the spring/summer of 2023. As shown in the published OHS budget documents, it is fairly common for City agencies to experience some adjustment to the budget during the course of the year.

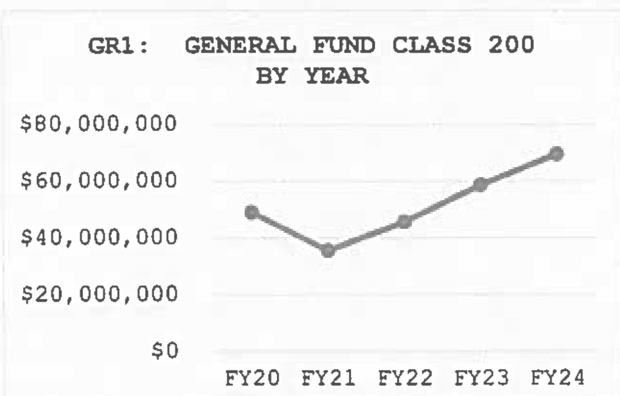
Within OHS, this decision was eventually communicated to staff and presented as authorization for the department to proceed through FY22 without regard to the $4 million cut. OHS staff at the Deputy level have varied descriptions and recollections of this edict, and varied understandings of the department's financial health over the years, but all were generally consistent that Hersh believed she had authorization for all subsequent spending through her departure in 2023.[15]

IV. Transaction Costs & Program Expansion

Unfortunately, to define the OHS deficit as equal to this $4 million gap is a gross over-simplification, largely because it does not account for the cumulative effect of carrying this debt from year-to-year. And to effectively manage the debt, the department, in particular the Deputy of Fiscal & Contracts, had to then engage in a series of somewhat misleading and consequential financial transactions to keep the providers and the department afloat – essentially a shell game to defer costs.[16]

Two important corollaries also follow through FY24. First, OHS could not withstand any increase in operating costs on existing contracts, regardless of scale. Because the department was already under-funded, a cost increase anywhere on the provider side just added to the deficit dollar-for-dollar. Second, any new or expanded project or program would also represent more debt. Even if given an additional appropriation for such work, a portion of any new General Funds would have to be allocated to prior, already incurred, service costs.

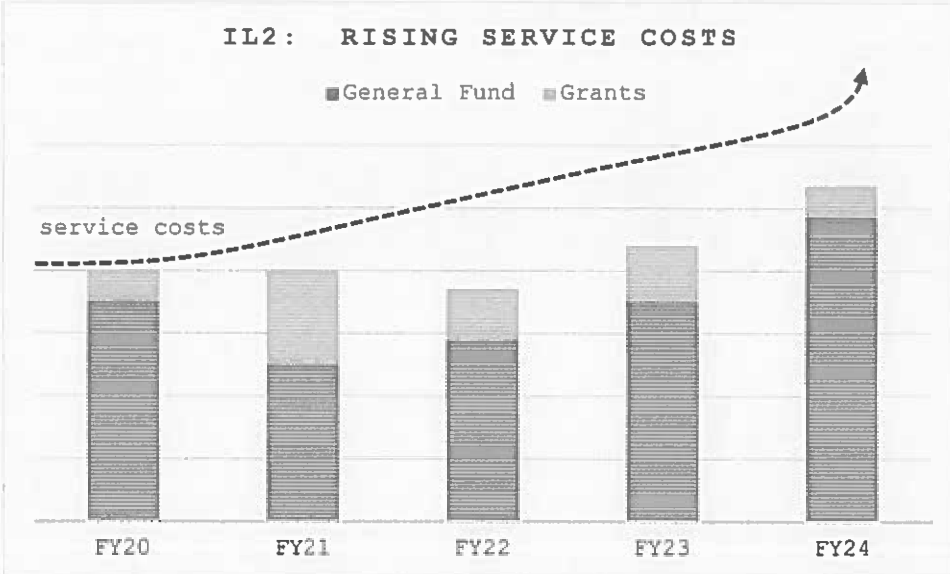
On the program side of the office, over the last few fiscal years, these two compounding circumstances did occur to quite a significant extent. Driven by Hersh's leadership and the social environment through COVID, OHS experienced an overall climate of growth and expansion during this same period. The department was faced with a variety of serious cost increases related to *(i)* the pandemic response and COVID hoteling costs, *(ii)* inflation and supply chain market increases, *(iii)* field and facility security, *(iv)* building maintenance and repair, *(v)* a series of unanticipated encampment issues, *(vi)* the more recent migrant response, *(vii)* extended year-round programs that were previously seasonal, and *(viii)* extended programs that were previously funded wholly by grants.[17]



The OHS Class 200 General Fund appropriation has also grown over the last few fiscal years, as shown in *Graph 1* to the left. As such, this environment of program growth did not fully explode the department's deficit, but it certainly shows that the shorthand understanding of a $4 million hole was not an accurate representation of the OHS financial position.

[15] There is no evidence that any MDO representative had specific knowledge of the underlying OHS financial activity to follow, and Hersh herself clearly had limited understanding. Even as expressed during her OIG interview, Hersh used the term "deficit" to define the gap between the needs of the homeless and the City's resources – she viewed it her job to close that gap. There is also a record of OHS staff challenging certain decisions to spend resources in coming years, but the needs of the homeless population always outweighed financial considerations.
[16] Later sections address the specific contract and financial transactions.
[17] Again, this is a broad presentation of the program activity, included here to illustrate the general idea that growth outpaced funding regardless of source.

In reality, the department's activity more closely resembled *Illustration 2*, below.



As shown here, the service level bent sharply upward over time, as did appropriations, but costs and resources were still misaligned. Through FY23 and FY24, OHS began to lose an accurate accounting of the precise level of debt, for reasons discussed in greater depth below. And accordingly, later attempts to balance the department were insufficient.[18]

V. Carrying The Debt - The Basic Tools

In addition to increasing program costs across OHS, the manner in which the department actually carried the debt also introduced some important operational complexities that further obscured the financial picture. Most directly through the OHS Fiscal Deputy and his staff, the department managed the deficit through administration of the professional services contracts and General Fund encumbrances and payments.[19] They used four basic tools.

First, when contracting with a non-profit vendor, OHS as a department enjoys a specifically articulated exemption from the requirements of Chapter 17-1400.[20] If the counterparty to an OHS contract is a qualified non-profit, the department may legally enter into that contract directly, without an RFP and outside of a competitive bidding process. Of the roughly 170 contracts administered at OHS, the large majority qualify for this exemption, allowing OHS to more quickly and easily conform contracts with less involvement from outside agencies, like the Procurement Department.

[18] Working with the MDO, Hersh and the department did attempt to resolve the deficit at some point during the FY23 budget cycle. At that time, however, OHS presented and quantified their need as roughly $4 million—generally the delta discussed above. OHS was granted this appropriation, but that did not account for other program growth and did little to affect the debt that had already accumulated.

[19] This is mainly because the OHS budget is roughly 80%-85% Class 200 in any given year, and the professional services contracting process is far more malleable than other spending, outlined in greater depth below.

[20] *See* Phila Code §17-1406(8).

Second, OHS would not fully encumber General Funds. In order to properly finalize a contract, operating departments must specifically designate a funding source and amount for each contract – set an encumbrance to reserve funds for payment. The encumbrance amount need not be equal to the full face-value of the contract, and there are many justifiable reasons why a department might not wish to fully encumber on any given contract.[21] But with OHS, this was a habitual practice born largely out of the need to manage the deficit.[22] In fact, it was impossible for OHS to fully encumber because expenses exceeded the yearly appropriation.

Third, because the department did not have all of the funds available in any given fiscal year, provider invoices could not always be processed and paid on time. So, in order to pay invoices that were outstanding at the end of the year, the department processed and issued the payments in the following fiscal year after the new budget was available. Of course, this does not resolve the debt, but only defers it and compounds the problem.

Fourth, these outstanding payables not only crossed fiscal years, but also contracts. That is, OHS could not necessarily square the vendor at the end of a specified contract term, including renewals in some cases. So, the unpaid invoices from the old contract were passed on to a new contract with the same vendor – and the same basic scope of services but a new term and a new record number. Here, it appears the department may have lost some control over vendor costs on any given contract, making the reconciliation process far more difficult.

1. Conforming Contracts – Face-Value v. Budget

Fundamentally, this deficit exists because OHS entered into too many contracts of too much value. This was a deliberate agency action that cannot be ignored and is very clearly evidenced by the department's internal planning documents. The Fiscal Deputy maintained a spreadsheet that presented the sum total of the department's financial commitments for any given fiscal year – every contract and its face-value, organized by program and funding source. This document was iterated throughout the year, as OHS went about its spending and contracting activity. Hersh confirmed that about every month she reviewed this spreadsheet. Hersh would then generally direct adjustments as the agency's needs and costs changed – new contracts, amendments, increases, etc.

T1: OHS ACCOUNTING OF GENERAL FUND

	2/6/23	3/24/23
Grand total [GF]	61689891	64849456
FY23 Class 200 Funding	61113570	61113570
Balance	-576321	-3735886

Table 1, to the left, is an excerpt from the FY23 planning document. Note the growing negative balance from February to March.

Understanding that this document is not a reflection of amounts paid, it straightforwardly confirms that OHS knowingly committed to obligations that exceeded available funds. Total face-value of the department's contracts was greater than the budget.

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[21] Grant funding, for example, is the most typical reason that a department might not wish to fully encumber with General Funds. A prudent department might also build some margin of error into a contract, anchored in cost projections, to account for uncertainty.

[22] Aside from grant funding complexity, OHS typically expected each contractor to bill for the full contract amount.

Notably, central approval from a Finance Department (Finance) representative is required before a contract may be conformed, regardless of non-profit status. In ACIS, the first Finance conformance step is titled "Budget Verification," and is completed by a Finance user, typically the assigned Budget Analyst. In theory, this Finance approval step should include some reference check back to the Class 200 budget appropriation. The Analysts' general task is to check that the department has budget authority to enter into the contract.

For a small department with a low number of contracts and limited financial authority, a Budget Analyst can fairly easily see if any given contract is going to exceed the budget if fully paid – essentially analyzing the face-value of the contract catalog against the appropriation. In practice, however, for a department like OHS that has a considerable Class 200 balance and carries a high number of contracts, many of which are funded through grants, this exercise is far too complex to gain an accurate picture of how any single, small-value contract would impact the budget.

In this case with respect to OHS, this Finance step was essentially a perfunctory verification to ensure that there was a valid encumbrance in place, even if quite small in relation to the total value of the contract. As long as funds were available to meet the encumbrance, and the contract amount had not been exceeded, Finance approval was routinely granted to OHS as they entered into contractual agreements.

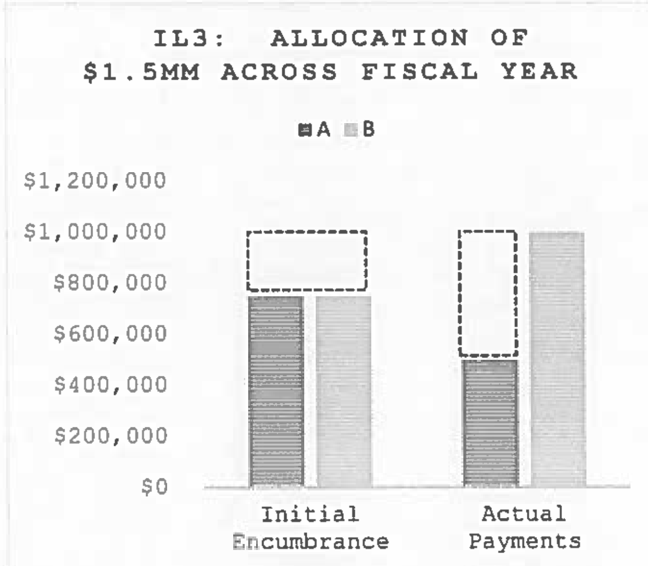
2. *Manipulated Encumbrances*

Finance Department controls in contracting are more directly aimed at comparing the face-value of the contract to the encumbrance and payment amounts, rather than some broader reference to a department's overall budget authority. Before a contract can be finalized and, therefore, in a position to pay invoices, ACIS and/or FAMIS administrators must specifically designate a funding source and amount – within OHS, staff referred to this as "funding the contract."

Of course, FAMIS will not allow total encumbrances to exceed the budget balance. So ideally, the encumbrance on any given contract should equal the face-value, forcing departments to ensure that funds are available for the requested services. OHS fiscal staff, however, were not subject to any central oversight or second-level authorization with respect to encumbrance amount. For the most part, the encumbrance or "funding" amount was at the discretion of the Fiscal Deputy and/or staff under his control.

Accordingly, the vast catalog of service contracts at OHS have been well under-encumbered for many years. As a matter of general practice, each contract encumbrance was initially set at roughly 25% of the contract's face-value at the beginning of the term. And, these values were continually adjusted throughout the fiscal year – either increased to allow for more payments to the contracted vendor or liquidated to allow for payments to another.

Illustration 3, to the right, shows the simple skirting of this important control. Assume both Vendor A and Vendor B have entered into fiscal year service contracts, valued at $1 million each. Assume the department, however, has only $1.5 million actually available for distribution in FAMIS, rather than the required $2 million. To manage the deficit, the department begins the year with two encumbrances of $750,000 each, totaling the budgeted $1.5 million. As the year continues, and depending on contractor activity, the department can adjust these encumbrances, liquidating Vendor A to half the required level and increasing Vendor B to allow for full payment. Thus, Vendor B ends the fiscal having been paid the full $1 million for its services and Vendor A must wait until a subsequent fiscal year to receive the remaining $500,000.



The OHS practice of passing invoices to the next fiscal year is discussed in greater detail below, but when this activity is combined with the real-time adjustment of FAMIS encumbrances, it is clear to see how the department could continually operate at an ever-growing deficit. These manipulations are then further amplified by the sheer volume of service vendors at OHS, giving the department significant ability to manage the debt and make targeted payment selections.[23]

3. *Vendor Payment Processing – Crossing Fiscal Years*

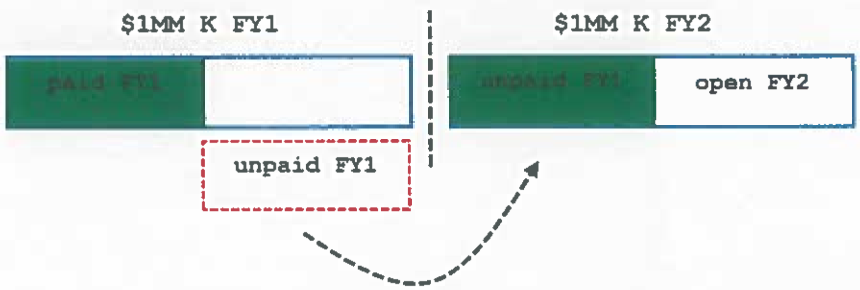
As a direct consequence of the above activity, between FY21 and FY24 the department was forced to hold a significant number of unpaid invoices until additional General Funds were available – quite clearly because they had spent the entire departmental appropriation. Shortly after the start of each fiscal year, the General Fund budget is "loaded" and each department is then able to disburse those funds, drawing down from the designated FAMIS account with an initial balance equal to the approved budget amount. When the OHS balance was fairly high, in the early months of the fiscal, OHS would typically submit payment vouchers to Finance for contract services that took place in the prior year – to pay what was owed.

Finance's Payment Verification Unit flagged a great number of these vouchers,[24] especially as the activity became more frequent through the summer of 2023. Staff in the Payment Verification Unit frequently questioned the OHS fiscal staff, at various levels, to flag the issue – prior year costs were being applied to the current year. As such, the department would need to make some other spending adjustment[25] moving forward, a fact that Finance representatives regularly pointed out.

[23] At times, the department was forced to choose which bills to pay and which to defer. These decisions were made ad-hoc, considering factors like invoice timing and vendor complaints. Smaller organizations with less liquidity and fewer non-City revenue streams were also favored over larger organizations that could presumably endure delay.
[24] This unit maintained historical record of various issues in OHS-related payment vouchers.
[25] And/or potentially amend the contract – discussed in later sections.

Illustration 4, below, is a visual representation of the long-term impact of this practice. In this example, assume Vendor A holds a $1 million service contract with a simple two-year term. As before, assume the vendor performed the work and submitted $1 million in invoices in the first year. The department, however, can only pay $500,000 and shifts the remaining payable to the next fiscal year. The funds are available in the new budget, so the second half of the contractor's invoices can be paid in FY2.

IL4: PAYABLE ACROSS FISCAL YEAR



But this leaves little room for additional payments in the second year. Unless the department limits the contractor's second-year work, or finds equivalent cost savings elsewhere, the deficit will continue to grow because another $500,000 in payables (or more) will have to wait until the third fiscal year.

Within the Payment Verification Unit and in the individual payment vouchers, there is a fairly robust record of Finance staff frequently questioning OHS fiscal staff and, at times, cautioning them about this practice. Ultimately, however, vouchers of this character were typically resolved with some form of acknowledgment by OHS fiscal staff, often written in a simple memo.

For example, in connection with a March 2022 voucher,[26] the former OHS Budget Officer wrote:

> To whom it may concern:
>
> Due to underfunding of the Bethesda Serentiy House contract number 18-20247 in FY21 we were not able to pay the full amount of the June 2021 invoice. The Office of Homeless Services would like to pay the remaining balance of $10,000 for the June 2021 invoice out of the current contract 22-20283. The contract will be amended to include the outstanding invoices.

This is just one of many instances in which OHS openly moved payables across fiscal years. For any single payment of this character, Finance ultimately processed it, largely because the work had already been done and the department represented awareness of the need to take corrective budgeting action moving forward. As a legal matter, the City owed a vendor for contracted work that was performed to the satisfaction of the operating department – the money was owed. For each of these payments, there was a contract, a debt and funds available at the time to authorize disbursement.

[26] Voucher No. PVMD22015115.

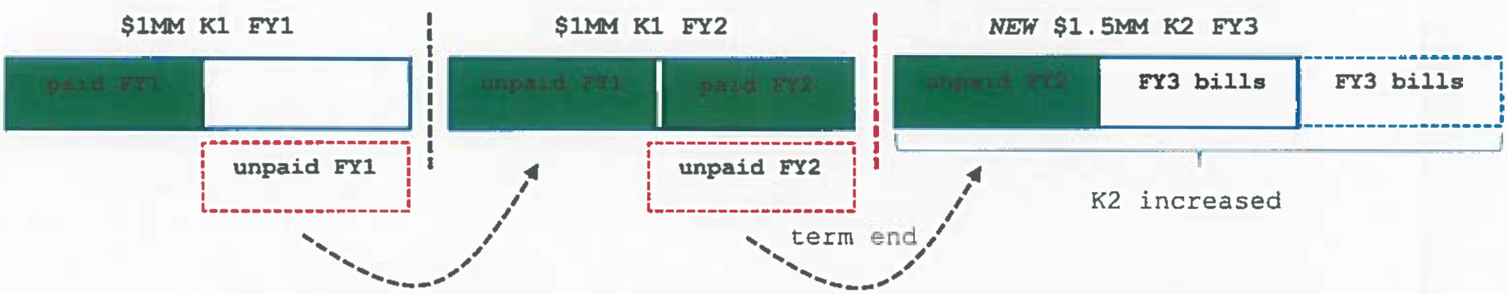
4. *Debt Across Contracts – Squaring the Contractor*

The excerpt from the departmental memo above references the final, and potentially most harmful, transactional implication of the OHS deficit. Note that the memo referenced a new fiscal year *and* an entirely new contract. This particular payment, therefore, was for services that were rendered under one contract but paid under another. Theoretically, OHS could pass the debt from one fiscal year to the next without limitation, but eventually the contract term and available renewals[27] would come to an end, forcing a payment to be moved to a new contract.

This is significant because both ACIS and FAMIS are centrally organized to track encumbrances and payments back to face-value of the contract, to ensure that contracts cannot be paid in excess without amendment. The use of carryover payables and new contract numbers introduces serious complexity when trying to understand exactly what was paid to any given vendor on any given contract. And, to make the vendor whole, the new contract must be amended and increased.

Illustration 5, below, shows the sequence. Again, assume a $1 million service contract with a two-year term. If at the end of the second fiscal year, Vendor A has still not been paid the outstanding $500,000, that payable must be resolved in the third fiscal year on a new contract. Of course, in that year, the contractor is going to work and bill for $1 million. To square Vendor A in the third fiscal, the department must amend the second contract to allow for a total yearly payment of $1.5 million.

IL5: PAYABLE ACROSS FISCAL YEAR & CONTRACT



At the very end of all these transactions, the payment record for Vendor A will show that the contractor was underpaid for the first two years[28] and paid in full on a much larger contract in the third.[29] The contractor has been paid the correct total of $3 million over the three years he/she has been working for the City, but one would need specific knowledge of the contract sequence in order to understand this activity in the aggregate rather than on a contract-by-contract basis. Here, OHS has created a very tangled network of successive contracts, amendments and deferred payments – apparent inconsistencies abound.

To boot, these contract amendments risk vendor misunderstanding. In order to amend any contract, the counterparty must approve and sign. If the reason for the amendment is not clearly articulated, the vendor might interpret the value increase to be approval for increased work and more billing.

[27] The bulk of OHS service contracts are for an initial one-year term, followed by three or four yearly renewals.
[28] Receiving $1.5 million on a contract with a value of $2 million over two years.
[29] Receiving $1.5 million on a contract with a value of $1.5 million over one year.

For example, using Illustration 5 to frame the issue, if OHS does not inform Vendor A that he/she may only bill for a total of $1 million in year three (because the other $500,000 in contract value is only to resolve the passed invoices from the prior year), he/she could easily believe that $1.5 million worth of *new* work has been approved.[30]

VI. Other Considerations

The financial transactions discussed above are the basic building blocks that OHS employed to acquire the deficit that it now faces. In many ways, however, this is an overly simple presentation. There are quite a few additional factors that amplify some of the above discussion, mostly because they introduce additional timing complexity that makes planning more difficult.

1. Grant Funding

The OHS financial practices discussed in this report are essentially inoperable with respect to grant funding. This is primarily because grant funding is *(i)* discrete and *(ii)* on a highly variable calendar. And, FAMIS has separate encumbrances for grants, so even if a contract was partially funded with grant money, there will always be a very clean and clear record of exactly what was paid with those funds.

The OHS financial transactions evidence a cash-flow game that leverages periods of high liquidity. Because grants arrive on unique calendars and are not recurring there is no meaningful difference between paying an expense in one fiscal year or another. As long as the expense qualified, according to the grant terms, it could be paid at any time allowable under the grant.[31]

The department's frequent use of grant funds simply adds temporal uncertainty and makes many of the OHS transactions much more difficult to flag or control from central Finance. For example, at either the time of contract conformance or later during the term, the prospect of an incoming grant could easily explain why any given contract was "under-funded." OHS would not need to encumber General Funds if they were expecting a later infusion of grants. The "Budget Verification" check discussed above is also made much more difficult, if not impossible, because the departmental Budget Analyst will typically not have knowledge of the grant calendar and balances would not necessarily be visible on any specific budget document.

2. Retroactive Contracts & Emergencies

At times, the department authorized certain cost increases and/or new contract work without first conforming or amending a formal agreement. Thus, there were certain instances when a contractor began new work before the OHS fiscal staff had prepared the proper structure in ACIS and FAMIS and fit the expense into their network of encumbrances. Naturally, this creates a high risk of error because it requires clean communication and coordination between the vendor, the program staff and fiscal staff.

In the department's contract with U.S. Facilities, for example, the vendor had OHS authorization to increase its scope of work for a significant period without a corresponding contract amendment. With no

[30] There is at least one anecdotal account of such a misunderstanding, but it did not result in overpayment.
[31] Notably, OHS also employs additional controls at the payment stage, to ensure that the precise charges on any given invoice are eligible for the grant to which those charges are applied. This investigation will continue to assess grant compliance, discussed in Section VII.

contract adjustment, there was no encumbrance and no opportunity to understand how the expense would otherwise be funded. Once again, the department was forced to carry the payable across another fiscal year.[32]

3. Multiple Contracts, Advance Payments & Adjusted Invoices

In a few cases, OHS held multiple contracts with one vendor on overlapping terms.[33] This introduces the possibility that some costs may have been shifted across contracts, though this investigation has not yet identified evidence of such activity. For these vendors, OHS could even more heavily utilize the debt-management tools presented above – there is more opportunity move payables.

Several OHS contracts also included an advance payment to the vendor, made at the beginning of the term.[34] This payment was then supposed to be recovered through discounts applied to subsequent invoices under that contract. As payables crossed fiscal years and contract numbers, OHS and/or Finance could easily have lost sight of the need to discount later invoices. Here, there is a significant possibility of over-payment.

Also, the Payment Verification Unit noted a number of revised invoices that were initially paid but then resubmitted for an additional adjustment after-the-fact. In the contract environment that OHS created, this adjustment is highly prone to error because any single invoice could, theoretically, be for work on one contract, paid on a second contract and then adjusted on a third.

4. Contracts with Shared Expenses

Between FY21 and FY24, some of the OHS spending was driven more directly by the MDO. Much of the pandemic and migrant response, for example, included additional spending on existing OHS contracts or new contracts that were sourced from the MDO budget rather than the department's.[35] The burden to administer this work, however, laid squarely on OHS. Without question, this practice introduced planning intricacy for OHS and further obscured the true departmental debt.

5. Purchase Order Spending

Some of the unexpected cost increases during this period also came from vendors on City-wide contracts. Because the department does not directly hold the contract, payments must be made through Purchase Orders (P/Os) and cannot easily be earmarked in advance. For these expenses the department must budget more actively, estimating yearly costs without the use of a contract.

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[32] *See* Contract Nos. 18201141 and 2220101.
[33] Example vendors include: the Urban Affairs Coalition, Congreso De Latinos Unidos and PHMC.
[34] Examples include: Contract No. 2120632 (New Journey), Contract No. 2320897 (New Journey), Contract No. 2320202 (SELF) and Contract No. 2320581 (Prevention Point).
[35] Both U.S. Facilities contracts referenced above, for example, included expenses requested and paid for by the MDO.

IL6: BASIC FAMIS CLASS 200 BUDGET

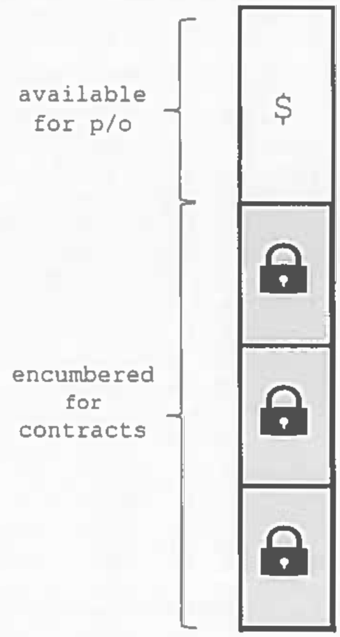

Illustration 6 presents the basic Class 200 budget concept. Funds that are reserved for contracts are locked, leaving some amount of free funds for P/Os. In recent fiscal years, that freedom was minimal for OHS because they carried too many contracts, as discussed above, meaning that a sudden increase in a cost on the P/O side would also grow the deficit.

Such was the case with Scotlandyard Security Services. Starting in the summer of 2020, OHS engaged this vendor to increase security services but made no other adjustments to spending. Thus, at the end of the fiscal year, there were insufficient funds and the department paid the bill using a P/O in the following fiscal year – FY22.

6. *Calendar Year Contracts*

Beginning in calendar year 2023, the City allowed OHS to move some service contracts to the calendar year, rather than the fiscal.[36] Although this move clearly did not create the deficit, it added greater variance to the contractor billing and payment cycle. Essentially, this just aided the department's ability to manage the debt because not all vendors would be billing on the same schedule. Thus, it was less likely that OHS would face pressure from multiple vendors for payment at the same time – a "bank run" could have effectively crippled the department.

VII. Analysis & Recommendations

On the whole, this review has painted a picture of a department that was financially unable to keep up with its growth. Leadership was driven by the mission, and fiscal considerations became an afterthought. The OHS Fiscal & Contracts Unit was quite siloed, rather than fully integrated, and placed in a support position to somehow enable the mission-driven work. Really, the only way for the department to operate in this environment, without making a service cut, was to leverage the budget cycle. These financial manipulations eventually spun the department into deeper and deeper debt, while also making it more difficult to properly assess the deficit and correct course.

Although we may understand the character of the transactions from the department's side, there are many open questions remaining about the vendor activity. With all of this contract complexity and retroactive payment activity, the risk of overpayment and/or overbilling appears significant. Given the discussion above, there are quite a few opportunities for a contractor to either intentionally or unintentionally inflate an invoice, include an unapproved cost or even double bill.

[36] This was a pilot program of the Office of the Chief Administrative Officer, intended to address administrative delays in payment processing and contracting across fiscal years.

Looking backward, the only way to properly assess the risk is to painstakingly unravel the department's morass of service contracts, payment by payment. The OIG will, of course, continue this exercise to identify possible overpayments, fraud and/or grant non-compliance.

Moving forward, the OIG offers the following recommendations in an effort to improve internal controls and prevent either OHS or another City department from acquiring such harmful debt. Any combination of these recommendations would likely have brought deeper scrutiny to the OHS deficit and lessened it to some extent.

1. Strengthen the "Budget Verification" Process in Conformance.

As stated above, OHS simply conformed contracts of too much value. There may have been an opportunity for a Budget Analyst to have seen that in ACIS while approving conformance steps. Understanding that grant funding adds serious complexity to this task, especially for departments like OHS that already have large Class 200 appropriations, the Finance Department could build additional process into this check to include some evaluation of the department's total contract catalog as compared to its authorized budget.

2. Impose Stricter Encumbrance Rules.

OHS under-encumbered fundamentally because they did not have the General Fund balance. Although there may be perfectly legitimate reasons for any given department to under-encumber, as pointed out above, this was clearly an indication of the larger OHS financial position. If Finance centrally controlled encumbrance amount, or if there were some threshold requirements that required justification to deviate, the OHS budget deficit would have been easily discovered.

3. Collect and Track More Data from the Finance Payment Verification Unit.

For any single payment of prior year invoices, the payment was rightly authorized by Finance because the work was completed to the satisfaction of OHS. But, as time passed and the activity became more frequent, OHS demonstrated a clear pattern that pointed to a very serious budget problem. The Payment Verification Unit could build some straightforward data tracking to get a better picture of a department's activity in the aggregate and initiate earlier interventions when red flags arise.

4. Evaluate the Scope of the Non-Profit Exemption.

Although it may be difficult to quantify, the department's use of the non-profit exemption bolstered this activity because they could conform contracts much faster than most other departments. And, it is an attractive reason for other City departments, like the MDO, to seek cost-sharing arrangements that complicate the OHS budget. Generally, OHS created and managed a unique market for services that was fairly unregulated and not driven by pricing competition. For one or two contracts, this is less of a problem. But, with more than 150 non-profit vendors, the lack of market controls gave OHS a certain freedom to work with their vendors on more of an informal and relationship-driven basis.

5. Restrict the Use of General Funds and Grant Funds on a Single Contract.

Understanding that this may be cumbersome to segregate for many departments, the mixed use of grant funds and General Funds on any single contract clearly concealed the deficit to some extent. A restriction on this ability would have made the deficit far more visible. As a matter of record-keeping and forensic investigation, this separation would also have mitigated many of the fraud and overpayment risks identified elsewhere in this report.

The OIG stands ready to assist in any way possible. We thank the employees at the Office of Homeless Services for their continued cooperation with this inquiry.

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David Holloman
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Alexander F. DeSantis
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Philadelphia, PA 19106

April 11, 2024

Dear Inspector General DeSantis:

The Office of Homeless Services has received and reviewed the report outlining the findings of the Office of the Inspector General's investigation into OHS's budget overspending.

OHS believes the findings to be fair. Additionally, our Office will consider the guidance and every suggested action step, tactic, and tool to mitigate future budgetary mishaps. In fact, I have already developed the framework for a comprehensive corrective action plan that is designed to improve fiscal operational procedures — ensuring there is never another occurrence of budget overspending again.

Thank you for the opportunity to review and respond to the report.

In Service,

David Holloman
Executive Director
Office of Homeless Services