North Carolina Department of Commerce, Raleigh, NC

Neighborhood Stabilization Program Grants 1 and 3

Office of Audit, Region 4
Atlanta, GA

Audit Report Number: 2019-AT-1004
June 14, 2019

To: Matthew King, Director, Office of Community Planning and Development, 4FD

//Signed//

From: Nikita N. Irons, Regional Inspector General for Audit, 4AGA

Subject: The North Carolina Department of Commerce Did Not Administer Its Neighborhood Stabilization Program Grants as Required by HUD

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the North Carolina Department of Commerce's administration of its Neighborhood Stabilization Program grants 1 and 3.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.

Audit Report Number: 2019-AT-1004
Date: June 14, 2019

The North Carolina Department of Commerce Did Not Administer Its Neighborhood Stabilization Program Grants as Required by HUD

Highlights

What We Audited and Why

We audited the North Carolina Department of Commerce's Neighborhood Stabilization Program (NSP) grants as part of our annual audit plan because the Department received more than $57 million in NSP1 and NSP3 funding. Our audit objective was to determine whether the Department administered its NSP1 and NSP3 grants in accordance with the U.S. Department of Housing and Urban Development's (HUD) requirements.

What We Found

The Department did not administer its NSP1 and NSP3 grants in accordance with HUD's requirements. Specifically, it did not deobligate grant funds in a timely manner, reallocate grant funds with proper justification, maintain adequate documentation to support grant expenditures, properly track program income, and ensure that six NSP activities met their national objectives.[1] These conditions occurred primarily due to a lack of written and implemented policies and procedures. As a result, the Department (1) allowed more than $417,000 in grant funds to remain unused, (2) improperly reallocated $1.3 million in grant funds, (3) used more than $1.1 million in grant expenditures without adequate supporting documentation, (4) underreported at least $6.1 million in program income to HUD, and (5) drew down more than $11.9 million in grant funds without showing that a national objective was met.

What We Recommend

We recommend that the Director of HUD's Greensboro, NC, Office of Community Planning and Development require the Department to (1) reprogram and put $417,113 in NSP1 funds to better use, (2) support more than $2.4 million or reimburse its NSP grants from non-Federal funds, (3) reconcile and update the NSP program income reported to HUD, and (4) develop and implement a remediation plan to show that national objectives have been met as required to support more than $11.9 million in program funds. We also recommend that the Director review the Department's expenditure of the remaining $736,088 in NSP1 grant funding before its drawdowns.

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[1] In summary, there are three national objectives: (1) benefiting low- and moderate-income persons, (2) preventing or eliminating blight, and (3) meeting other community development needs with a particular urgency.

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Background and Objective

On July 30, 2008, Congress authorized, under Section 2301 of Title III of the Housing and Economic Recovery Act of 2008, $3.92 billion for the Neighborhood Stabilization Program (NSP) to provide grants to States and certain local communities to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem the decline in value of neighboring homes. Grantees are required to spend 100 percent of their allocation within 4 years after receiving those funds. This round of funding is known as NSP1.

On July 21, 2010, Congress provided an additional $1 billion under Section 1497 of the Dodd-Frank Wall Street Reform and Consumer Protection Act on a formula basis to continue assisting State and local governments in the redevelopment of abandoned and foreclosed-upon homes. Grantees are required to spend 100 percent of allocated funds within 3 years from the date on which their grant agreement is signed with the U.S. Department of Housing and Urban Development (HUD). This round of funding is known as NSP3.

The North Carolina Department of Commerce was responsible for administering the NSP grants for the State. In March 2009, the Department received an allocation of more than $52.3 million in NSP1 funds, and in March 2011, it received an allocation of $5 million in NSP3 funds. As of March 2019, the Department had disbursed more than $51 million of its NSP1 funds and all of its NSP3 funds, leaving $736,088 in NSP1 grant funds available to draw.[2]

The Department planned to use NSP1 and NSP3 funds for the following types of activities defined in its substantial amendments:

- Establishing financing mechanisms for the purchase and redevelopment of foreclosed-upon homes and residential properties.
- Purchasing and rehabilitating homes and residential properties that have been abandoned or foreclosed upon, in order to sell, rent, or redevelop them.
- Demolishing blighted structures.
- Redeveloping demolished or vacant properties.
- Establishing land banks for homes that have been foreclosed upon.

Our audit objective was to determine whether the Department administered its NSP1 and NSP3 grants in accordance with HUD's requirements.

[2] HUD required at 24 CFR (Code of Federal Regulations) 570.504(b)(ii) that grantees disburse program income earned before requesting additional funds. Therefore, the Department could have funds remaining to draw down after the expenditure deadlines of 4 or 3 years from 2009 and 2011, respectively.

Results of Audit

Finding: The Department Did Not Administer Its Neighborhood Stabilization Program Grants in Accordance With HUD's Requirements

The Department did not administer its NSP1 and NSP3 grants in accordance with HUD's requirements. Specifically, it did not deobligate grant funds in a timely manner, reallocate grant funds with proper justification, maintain adequate documentation to support grant expenditures, properly track program income, and ensure that six NSP activities met their national objectives. These conditions occurred primarily due to a lack of written and implemented policies and procedures. As a result, the Department (1) allowed more than $417,000 in grant funds to remain unused, (2) improperly reallocated $1.3 million in grant funds, (3) used more than $1.1 million in grant expenditures without adequate supporting documentation, (4) underreported at least $6.1 million in program income to HUD, and (5) drew down more than $11.9 million in grant funds without showing that a national objective was met.

Grant Funds Were Not Deobligated in a Timely Manner

The Department did not deobligate grant funds in a timely manner. Specifically, it did not deobligate, or when it deobligated, it did not do so in a timely manner. We randomly[3] selected and reviewed 4 of the 13 NSP1 subrecipients and the only NSP3 subrecipient that had deobligated funds. The Department did not deobligate grant funds for three subrecipients until at least 2 years after the last drawdown by the subrecipients. In addition, at the time of our review,[4] the Department had not deobligated grant funds for three subrecipients, and the subrecipients continued to have grant funds available to draw down, although there had been no grant activity in 2 to 5 years. HUD required the Department to develop a policy for recapturing funds in the quickest way possible, based on its monitoring review.[5] However, when requested, the Department was unable to locate the policy for our review.[6] Without a policy to deobligate funds, the Department did not deobligate and make available $417,113 in program funds to other subrecipients that could have benefited from its use.

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[3] See the Scope and Methodology section of this report for our methodology for the sample selection.

[4] See the Scope and Methodology section of this report for details on the timeframe of our review.

[5] In its 2012 monitoring review of the Department's Community Development Block Grant (CDBG), HUD cited the Department for not recapturing CDBG funds.

[6] Although the policy was necessary for the CDBG program, the CDBG regulatory structure is the platform used to implement NSP. Therefore, this program is governed by CDBG regulations except when they are specifically waived.

Grant Funds Were Reallocated Without Proper Justification

The Department reallocated grant funds without proper justification. Specifically, it reallocated an additional $1.3 million in NSP1 grant funds in January 2018 to one of its subrecipients without a written justification for the award. According to 24 CFR (Code of Federal Regulations) 570.490(a)(2), the State must keep records to document its funding decisions reached under the method of distribution, including all of the criteria used to select applications from local governments. The Department explained that its basis for the reallocation was in its amended NSP1 action plan, which gave it the ability to lower or increase awards without having to seek competition. The action plan stated that the Department would deobligate and reallocate funds to high-performing subrecipients. However, the Department did not have a written definition of a high performer. It stated that it considered a high performer to be a subrecipient that (1) had a great project in the past, (2) could close quickly on a project, and (3) had completed a similar project before. However, in its own monitoring review of the subrecipient completed in June 2013,[7] the Department cited issues with labor standards, fair housing standards, and being consistently late with required reporting.

> A subrecipient requested and was awarded $1.3 million in NSP funds to complete a proposed project without a written justification.

Further, the funding approval letter issued by the Department for the subrecipient stated that the subrecipient requested and was awarded $1.3 million to complete its proposed project.[8] This project included the use of tax credits that could extend the time for the project to be completed, thereby keeping the NSP1 grant open longer.[9] The subrecipient submitted a voucher 1 year after the reallocation in January 2019 totaling $877,653, which was paid in February 2019. Nearly $422,350 of the $1.3 million in reallocated funds remained unspent as of February 2019.

NSP Expenditures Were Not Sufficiently Supported

The Department did not always maintain proper supporting documentation for its subrecipients' expenditures. We randomly[10] selected and reviewed a sample of 10 percent, or 10 drawdowns, totaling nearly $5 million from 105 NSP1 and NSP3 subrecipient drawdowns.[11] The Department was unable to provide sufficient supporting documentation, such as invoices, bills, and timesheets, for 4 of the 10 drawdowns totaling more than $1 million as required.[12]

In addition, the Department did not maintain proper documentation to support the NSP administrative or salary expenditures. We randomly[13] selected and reviewed a sample of 10 percent, or 9 NSP1 and NSP3, of the administrative drawdowns to determine whether

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7 The review completed in 2013 was the latest review of the subrecipient's first round of the NSP1 grant.

8 The additional funding was allocated for the subrecipient to build phase two of one of its apartment complexes.

9 The Department has had the NSP1 grant since it was awarded in March 2009.

10 See the Scope and Methodology section of this report for our methodology for the sample selection.

11 Our methodology for the sample selection is explained in the Scope and Methodology section of this audit report.

12 24 CFR 85.20(b)(6) and U.S. Office of Management and Budget Circular A-87, attachment B, subsection 8(h)(3)-(5)

13 See the Scope and Methodology section of this report for our methodology for the sample selection.

administrative and salary expenditures were adequately supported. All nine lacked adequate documentation to support the use of $279,813 in NSP grant funds. Further, we were unable to determine the type of expense as administrative or salary on two of the drawdowns due to a lack of sufficient information.

The Department stated that it did not have many of the documents to support the subrecipient or its administrative expenditures because of personnel turnover and because its fiscal department did not maintain the documents due to the age of the documents. Specifically, the Department's fiscal department's policy stated that documentation had to be retained for only 3 years after the fiscal year closed. However, according to 24 CFR 570.490(d), records must be retained for the greater of 3 years from closeout of the grant or the period required by other applicable laws and regulations. As the grantee, the Department was required to maintain records for all of its drawdowns, regardless whether the drawdown was for a subrecipient's need or its own administrative need.[14] The table below identifies the amount of each drawdown reviewed that was not adequately supported by the Department.

Table 1

Drawdown date	Type of drawdown	Total amount of drawdown	Drawdown amount not adequately supported
02/18/2010	Subrecipient	$287,273	$58,477
06/17/2010	Subrecipient	848,479	16,829
11/04/2010	Subrecipient	298,692	264,558
06/16/2011	Subrecipient	1,361,366	566,428
11/01/2010	Administrative	30,736	30,736
11/22/2011	Administrative	48,490	48,490
08/30/2012	Administrative	45,862	45,862
09/26/2012	Administrative	51,346	51,346
12/19/2012	Administrative	4,915	4,915
01/30/2013	Administrative	4,203	4,203
07/30/2013	Administrative	11,874	11,874
09/26/2013	Administrative	58,454	58,454
08/28/2014	Administrative	23,933	23,933
Total		**3,075,623**	**1,186,105**

Additionally, according to Office of Management and Budget Circular A-87, attachment B, subsection 8(h)(3)-(5),[15] charges to Federal awards for salaries and wages must be based on records that accurately reflect the work performed. However, the Department did not maintain timesheets to identify how employees spent their time on Federal grants. Instead, it allocated certain percentages to the grant, regardless of whether the employee spent that amount of time working on the NSP grant. The Department stated that it followed the guidelines for reporting

14 24 CFR 570.506(h)

15 As of December 26, 2014, this requirement was relocated to 2 CFR 200.430(i)(1).

time at the implementation of the NSP grant.[16] However, as detailed in table 1 above, the administrative drawdowns reviewed from 2010 through 2014 did not have adequate supporting documentation. The Department provided only coding sheets without details broken out as documentation to support salary charges to the grants.

Program Income Was Not Properly Tracked

The Department failed to properly track program income in HUD's Disaster Recovery Grant Reporting system.[17] Although, the Department provided program income information to HUD via its quarterly performance reports,[18] it had failed to enter program income information into HUD's reporting system since 2015. This condition occurred because according to the Department's business officer, a HUD technical assistance representative entered $10 million as estimated program income into HUD's reporting system in 2015, causing her to stop entering program income for fear it would inflate actual program income amounts. Additionally, the Department had no written procedures for tracking program income. The NSP specialist stated that she did not track program income in the reporting system because she did not know it was her responsibility.[19] She relied on the monthly reports from the subrecipients for program income information only for reporting in the quarterly reports. However, we reviewed the documentation provided by the Department and determined that the program income amounts entered into HUD's reporting system and on the quarterly reports did not match the program income documentation the subrecipients submitted to the NSP specialist. For example, for its subrecipient, City of High Point, the Department's records as of September 2018 identified $670,816 as program income. However, HUD's reporting system, as of the most recent data available at the time of our review, September 2018, and the latest quarterly report as of September 2018 identified only $59,323. The Department was unable to explain the difference. Further, based on the records maintained by the Department, the program income in HUD's reporting system and quarterly reports appeared to have been underreported.

In Federal Register notice 73 FR 58341 (October 6, 2008), section II O, HUD required that each grantee report on its NSP funds to HUD via HUD's reporting system and that HUD use grantee reports to monitor, reconcile, and calculate applicable administrative and public service limitations. Additionally, HUD's requirements at 24 CFR 570.504(b)(ii) provide that grantees and subrecipients must disburse program income before requesting additional cash withdrawals from the U.S. Treasury. Further, Federal Register notice 73 FR 58341 (October 6, 2008), section

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16 See the Background and Objective section of this report for NSP grant dates.

17 The Disaster Recovery Grant Reporting system was developed by HUD's Office of Community Planning and Development for the Community Development Block Grant Disaster Recovery program and other special appropriations such as the Neighborhood Stabilization Program. It is primarily used by grantees to access grant funds and report performance accomplishments for grant-funded activities. The recovery system is used by HUD staff to review grant-funded activities, prepare reports to Congress and other interested parties, and monitor program compliance.

18 The NSP quarterly performance reports include information on how grantees are using NSP funds. The performance reports contain project names, activity descriptions, project locations, national objectives, funds budgeted and expended, funding sources, numbers of properties and housing units, beginning and ending dates of activities, and numbers of low- and moderate income persons or households benefiting from the use of NSP funds.

19 Both the business officer and the NSP specialist reported to the program director, who was responsible for the overall administration of the NSP grants.

II N.2, provides that substantially all program income must be disbursed for eligible NSP activities before additional cash withdrawals are made. Therefore, reporting of program income in HUD's reporting system was essential to ensure compliance when requesting drawdowns from the U.S. Treasury. The Department did not report more than $6.1 million ($11,829,595 - $5,692,406) in program income to HUD via HUD's reporting system. The table below provides the program information maintained by the Department and program information reported to HUD via HUD's reporting system and quarterly report as of September 2018.

Table 2

Subrecipient	Department records	Date – Department records	DRGR* (as of 9/2018)	QPR** (as of 9/2018)	
				Drawn down program income	Received program income
Durham, City	N/A	N/A	N/A	137,776	N/A
Gastonia, City	$751,320	01/05/2018	472,244	472,244	472,244
Greensboro, City	165,504	02/05/2018	0	0	0
Habitat-Forsyth	239,897	12/15/2015	45,957	238,272	243,919
Habitat-Greensboro	625,030	09/29/2017	208,567	208,567	208,567
High Point, City	670,816	04/10/2018	59,323	59,323	59,323
Lexington, City	283,551	04/10/2012	283,551	290,051	283,551
NCCDI***	3,020,585	01/10/2017	1,682,034	1,682,034	1,682,034
NCHFA****	695,020	08/13/2018	280,600	379,856	280,600
Passage Home	814,764	08/10/2018	374,194	374,194	374,194
Raleigh, City	347,764	04/05/2018	237,906	237,906	239,271
Rocky Mount, City	654,075	07/07/2017	641,867	641,867	641,867
Saint Augustine	394,580	08/12/2018	64,801	64,801	64,801
Self Help	2,874,983	01/09/2018	1,341,362	1,542,358	1,543,271
Vance, County	291,706	07/26/2018	0	0	0
Total	**11,829,595**		**5,692,406**	**6,329,249**	**6,093,642**

*DRGR: HUD's Disaster Recovery Grant Reporting system
**QPR: quarterly performance report
***NCCDI: North Carolina Community Development Initiative Capital, Inc.
****NCHFA: North Carolina Housing Finance Agency

NSP Activities Did Not Meet Their National Objectives[20]

The Department was unable to show that some activities had met their national objectives. We reviewed open activities that had spent all of their grant funds to determine whether the activities

[20] HUD required that each funded NSP activity meet one of three national objectives. The national objectives are as follows: (1) benefiting low- and moderate-income persons, (2) preventing or eliminating blight, or (3) meeting other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community and other financial resources are not available to meet such needs.

met a national objective. We identified six activities that had not met their national objectives at the time of our review. Therefore, the activities were considered not complete, although all funding assigned to the activity had been spent.[21] According to HUD's requirements at 24 CFR 570.200(a)(2), grantees must maintain evidence that each program activity meets a national objective. In addition, regulations at 24 CFR 570.208 provide the criteria for determining compliance with the national objective requirement. The six NSP activities totaling nearly $12 million had start dates in either 2009 or 2012. Although program regulations do not impose a timeframe for completing activities, extended delays adversely impact potential program beneficiaries. This condition occurred because the Department did not plan properly to avoid extended project delays, causing activities to not meet a national objective in a timely manner. For example, one subrecipient, after exploring other avenues, entered into an agreement with its city government for assistance in completing its project because the NSP funding provided by the Department was not sufficient to complete the project. This subrecipient may have benefited from the more than $417,000 the Department failed to deobligate in a timely manner or the $1.3 million reallocated without proper justification. At the time of our review, the project was scheduled to be completed by the end of 2022, which would keep the NSP grant open longer. The Department drew down more than $11.9 million[22] in program funds for six activities without adequate support that a national objective was met. Grantees should take necessary precautions and plan properly to avoid extended project delays. The table below shows the funding for the six activities that had not been completed to meet a national objective.

Table 3

Activity	NSP funding type	National objective	Activity start date	Funding amount
1	NSP1	Low-moderate income	2009	$2,825,000
2	NSP1	Low-moderate income	2009	2,096,233
3	NSP1	Low-moderate income	2009	1,981,844
4	NSP1	Low-moderate income	2009	2,767,280
5	NSP1	Low-moderate income	2009	2,547,141
6	NSP3	Low-moderate income	2012	399,999
Total				**12,617,497**[23]

Conclusion

The Department failed to reprogram and put $417,113 in NSP1 funds to better use, did not maintain adequate documentation to support a reallocation totaling $1.3 million and grant expenditures totaling more than $1.1 million in NSP1 and NSP3 grant funding, underreported program income to HUD, and did not plan properly to ensure that six activities met their national

[21] In addition to not meeting the national objective, one of the six activities was not complete because it had funding available to draw. See the Scope and Methodology section of this report for details on the number of activities.

[22] We limited the questioned cost to about $11.9 million, although the total funding amount for the six activities was more than $12.6 million, because we questioned $701,425 associated with these activities due to insufficient supporting documentation as part of our NSP expenditure review.

[23] See footnote 22.

objectives to support more than $11.9 million in NSP1 and NSP 3 grant funding. These weaknesses occurred because the Department did not (1) have written policies for deobligating and reallocating NSP grant funds, (2) have a record retention policy that met HUD's record retention requirements, (3) have written procedures or train its staff on requirements for reporting program income, and (4) plan properly to avoid extended project delays, causing activities to not meet a national objective in a timely manner.

Recommendations

We recommend that the Director of HUD's Greensboro, NC, Office of Community Planning and Development require the North Carolina Department of Commerce to

1A. Put $417,113 in unspent NSP1 funds associated with three activities to better use by reprogramming the funds to other subrecipients using an appropriate method or return the funds to HUD.

1B. Support or reimburse its NSP1 grant $1,300,000 from non-Federal funds for the unsupported reallocation of grant funds.

1C. Establish and implement a written policy and procedures to recapture and reallocate unused NSP funds in a timely manner.

1D. Support or reimburse the appropriate NSP grant $1,186,105 from non-Federal funds for the unsupported subrecipient and administrative expenditures.

1E. Update its records retention policy to meet HUD's records retention requirements for supporting documentation for Federal program expenses, including salaries.

1F. Update the NSP program income information in HUD's grant tracking system and quarterly performance reports and reconcile with the Department's records.

1G. Establish and implement written procedures and provide adequate training to staff associated with administering the NSP grant to help ensure accurate reporting of program income.

1H. Develop and implement a remediation plan for the six NSP activities to show that the national objectives have been met as required to support $11,916,072 in program funds drawn or reimburse its program from non-Federal funds.

We also recommend that the Director of HUD's Greensboro, NC, Office of Community Planning and Development

1I. Work with the Department so that it plans properly to ensure that the six activities identified in this report meet a national objective thereby avoiding extended project delays.

1J. Review the Department’s remaining NSP grant expenditures before its drawdowns to ensure that the expenditures are eligible and adequately supported.

Scope and Methodology

We performed our fieldwork at the North Carolina Department of Commerce at 301 North Wilmington Street, Raleigh, NC. We performed our audit work from July 2018 through March 2019. Our audit period was January 1, 2009, through December 31, 2017.

To accomplish our objective, we

- Reviewed and obtained an understanding of the Department's policies and procedures, relevant laws, regulations, grant agreements with HUD, and HUD's guidance.
- Obtained and reviewed Department organization charts.
- Reviewed HUD monitoring reports.
- Reviewed the Department's 2012 Community Development Block Grant action plan and its substantial amendments for the NSP grants.
- Reviewed the Department's quarterly performance reports for both NSP1 and NSP3 grants.
- Reviewed the Department's financial records and files.
- Reviewed subrecipient files, including but not limited to timesheets, program income reports, vendor invoices, and drawdown requests.
- Interviewed Department employees and HUD staff.

Using a random number generator, we randomly selected and reviewed 4 of the 13 NSP1 subrecipients and the only NSP3 subrecipient that had deobligated funds to determine whether the Department deobligated funds in a timely manner. We did not review 100 percent of the universe because the sample included 49 percent of total NSP funds deobligated.

From a universe of 105 NSP1 and NSP3 subrecipient drawdowns totaling more than $52.8 million, using a random number generator, we randomly selected and reviewed 10 percent, or 10 drawdowns, of the NSP expenditures totaling more than $4.9 million and 9 drawdowns totaling $279,813 from the 91 NSP1 and NSP3 administrative drawdowns totaling more than $2.7 million to determine whether the expenditures were eligible and adequately supported. Drawdowns for the NSP expenditures included reimbursement requests from multiple subrecipients. Our sample of drawdowns included reimbursement requests from 15 of the 19 NSP subrecipients. Therefore, we did not review 100 percent of the universe. The results of the audit apply only to the items selected for review and cannot be projected to the universe or population.

We reviewed all of the quarterly performance reports, program income entered in HUD's reporting system, and the most recent subrecipient program income documentation to determine whether program income was properly recorded.

The Department identified six activities where a national objective was not met and that all funds had been used. However, we determined that one of the activities still had funds available to draw. We considered all six activities in our review as having exhausted all NSP grant funding based on the Department's explanation that funds were scheduled to be deobligated from one of the subrecipients. Therefore, the Department will need to consider all six activities in its remediation plan to ensure that national objectives are met.

We relied in part on computer-processed data in the Department's system to achieve our audit objective. Although we did not perform detailed assessments of the reliability of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes. The tests for reliability included but were not limited to comparing computer-processed data to vendor payments, financial records, and other supporting documentation.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that file maintenance, expenditure, and financial reporting activities are conducted in accordance with applicable laws and regulations.

- Validity and reliability of financial information – Policies and procedures that management has implemented to reasonably ensure that valid and reliable information is obtained, maintained, and fairly disclosed in reports.

- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that program implementation is in accordance with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe the following item is a significant deficiency:

- The Department did not (1) have written policies for deobligating and reallocating NSP grant funds, (2) have a record retention policy that met HUD's record retention requirements, (3) have written procedures or train its staff on requirements for reporting program income, and

(4) plan properly to avoid extended project delays, causing activities to not meet a national objective in a timely manner.

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1A		$417,113
1B	$1,300,000	
1D	1,186,105	
1H	11,916,072	
Totals	**14,402,177**	**417,113**

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the Department implements our recommendation, funds not used by subrecipients in more than 2 to 5 years will be available for other eligible activities consistent with NSP grant requirements.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments**

ROY COOPER
Governor

ANTHONY M. COPELAND
Secretary

KENNY FLOWERS
Assistant Secretary

May 21, 2019
Ms. Nikita N. Irons, Regional Inspector for Audit
75 Spring Street, SW, Room 330
Richard B. Russell Federal Building
Atlanta, Georgia 30303-3388

RE: North Carolina Department of Commerce/Community Development Block Grant (CDBG) -Auditee Comments and the Office of Inspector General's Evaluation, Letter of May 6, 2019

Program: CDBG Neighborhood Stabilization Program Grants NSP-1 and NSP-3

Dear Ms. Irons:

Thank you for meeting with us on Tuesday, May 14, 2019 to provide us with your draft review of our Neighborhood Stabilization Program Grants NSP-1 and NSP-3. We are taking the opportunity availed to us to respond with comments that will be incorporated in the Final Report. Our comments are presented below as follows:

De-obligated Funds:

Comment 1

In 2014, the Department of Commerce amended or restated the NSP Grant Agreement for NSP 1 grantees to address de-obligated funds and program income. With this document any remaining balance in the original line of credit was to be de-obligated and the terms and retention of program income was amended for each grantee. This was done with the assistance of HUD provided NSP TA. The majority of grantees agreed to the new terms but others that had outstanding reimbursement requests or projects needed additional time to complete this process. Since the grant remains open and HUD has stated that we have the ability to continue to work with grantees, we allowed those where we did not fully de-obligate funds the opportunity to submit additional draw requests such as in Vance County's situation. The County lost staff that were familiar with NSP but had outstanding requisitions that needed processing. Once we met the requirement of obligation, there was no clear timeframe given on when to de-obligate funds. The fact that there was no activity happening with the few grantees did not negate any outstanding payments that had occurred, and reimbursements had not been completed. Also, the law that governs NSP, states the funds are available until expended (FR Vol. 75. 201). All grantees that have funds will be notified within 30 days of the final report that their funds will de-obligated immediately.

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Re-allocated Funds:
In the State's NSP Policy and Procedures Manual, the State reserves the right to adjust contracted grant amounts based on progress and performance. Forsyth County in partnership with a non-profit and for-profit developer completed phase one of a foreclosed property that turned out to be an exceptional project. When they were monitored in 2013, they had issues, but those issues were addressed and did not carry forth to January of 2018. The local government representative contacted me in October of 2017 to ask if we had additional funds because they wanted to complete phase two of the Enclave Project and had been approved for tax credits. This gave the State the opportunity to utilize de-obligated and program funds on hand to help with the mission of the NSP Program. Since this was a tax credit, it allowed the process to be completed quickly and create additional affordable housing units since they had done this type project before. Phase I was expedited and met all of the requirements of an NSP Project. This project also won the NC Housing Award for Excellence. There is no indication that this project will keep the program open longer than necessary because there is no definitive timeline for NSP closeout. North Carolina is experiencing much of what is happening around the county in trying to closeout a very difficult program. The project does exactly what the goal of the program requires in taking foreclosed and vacant property and providing additional affordable housing stock. The program regulations do not speak specifically to de-obligation and reallocation of funds and how that should be accomplished. It does speak to spending funding on eligible projects which is what this project does. Within a year of awarding this grantee they have already expended over 68 percent of their funds, a commendable achievement. Tax credits have very stringent lease requirements and, therefore, should meet the national objective in a very timely manner. Our goal is reallocate all funds on hand so that we can continue to provide additional housing stock to the citizens of North Carolina.

Comment 2

NSP Expenditures:
Commerce acknowledges that a portion of the documentation that supported the administrative draws were not locatable at the time of the request from the OIG. During the period of the inspector's review, there were two different employees performing different duties for NSP administrative funds. The Administrative Officer was responsible for recruitment, accounts payable, small purchases and other billings while the Business Officer drew the funds needed to cover the expenses, reconciled federal funds, and performed all budgetary functions. While those documents were maintained in our office and provided to our HUD financial analyst during a monitoring visit in 2013 the Administrative Officer left the employment of Commerce in 2016 and files have been misplaced.

Comment 3

Action: All funds drawn from federal funds will be matched to their respective monthly report and a copy of any documentation will be attached to the report and filed for future audit reviews. With regards to salaries and wages, management asked for and was approved to hire staff dedicated to the implementation of the NSP program. Those hired include: one (1) NSP Coordinator/Section Chief, two (2) Rehabilitation Specialists, one (1) Compliance Specialist, one (1) Accounting Clerk and one half-time Rehabilitation Section Chief. At the time of hire, Commerce followed A-87 guidelines and provided time certifications to the field office when requested. According to the federal register notice released at the time, 2 CFR, Part 200 – Uniform Administrative Requirements for Federal Grants was implemented, any grants or costs thereof prior to 2015 will follow A-87 until closeout.

Comment 4

Comment 5

Action: Effective July 1, 2019, all employees paid from federal funds received from HUD will be cost allocated to the grant by use of object time codes in our states payroll system with time & effort reports documenting their work. In the interim, any employee working on more than one fund code will be required to submit time & effort reports at the end of each month.

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Program Income:
Records maintained for program income are now received on a monthly basis and are no longer submitted quarterly from our subrecipients. The report details the monthly expenses where program income was expended against eligible expenses and remaining program income. To date details include: program income generated to present, program income expended against NSP eligible expenses, and total remaining program income. Administrative details include: administration paid from program income, total administrative costs claimed against program income, and available administrative allowance. Our subrecipients update their reports monthly and denote when changes occur with program income earned and expended and record cumulatively. During the review of requisitions for reimbursement, program income was expended prior to reimbursement from the line of credit.

Comment 6

Pursuant to 570.426 funds received and retained by a Unit of Local Government is not considered program income if the amount does not exceed $24,999 cumulative within the year. However, if the received funds exceed $25,000 cumulative within a year then these funds are considered program income and would be subject to the requirements of 570.426 (a)(b)(c). To remain in compliance with this regulation, our grantees are required to reduce any request for federal funds by funds on hand or program income prior to drawing any additional federal dollars. Any funds received after all awarded NSP funds have been expended would be subject to requirements outlined in 570.509 (closeout) and must follow their amended Grant Agreement.

Comment 6

National Objectives:
As stated in the Draft Findings, "program regulations do not impose a timeframe for completing activities," and we are currently working with our recipients to develop a plan to ensure that planned projects meet a National Objective. North Carolina is not unique in this challenge considering that nationally of the estimated 600+ NSP funded projects less than 200 of these projects have been successfully closed and met a National Objective. HUD recognizes the complexity and challenge in fully implementing and closing NSP projects and have responded to Grantees with Closeout Webinars as a form of National TA response and through requests for individual TA with providing additional Closeout Guidance as recent as April 4, 2019.

Comment 7

In June of 2018, we requested NSP TA and had a brief discussion about our NSP program challenges with HUD on July 25, 2018. That TA was in the form of a conference call and had an introductory call. CDBG staff participated on the call to address the following: cleaning up flags in DRGR, NSP QPRs and delayed review and approval in DRGR by HUD once submitted by our NSP Specialist with the Department of Commerce. We also attempted to address questions that the CDBG Business Officer had about Program Income in DRGR that was entered as estimated by our assigned HUD TA provider prior to the call. Following the introductory call and brief discussions about our concerns our assigned HUD TA provider stated that we would receive follow-up at a time that was not scheduled during the call. To date the follow-up was not completed. We have since been offered TA by HUD for the NSP program with a strategic focus on programmatic and DRGR data components and working towards closing out NSP projects scheduled to begin Tuesday, May 14, 2019 at 2:00 pm.

Comment 7

The findings outlined in the OIG Draft Audit report also included the following statement that "extended delays adversely impact potential program beneficiaries." The Department of Commerce wants to assure HUD that we have not and will not delay in our efforts to monitor the progress of the recipients of NSP funding, including the provision of TA and assistance in strategizing to reach the accomplishments and beneficiary goals, meet National Objectives, and proceed with closeout of the six (6) remaining activities identified in the OIG review. Through these efforts, if we determine that a National Objective cannot be met, we will consider our options to (1) transfer NSP funds to our regular CDBG program or (2) return

Comment 7

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Comment 8

NSP funds to the U.S. Treasury. We are requesting that the OIG reviewers reconsider converting this item from a finding to a recommendation which includes TA from HUD specific to the six (6) NSP activities.

I am hopeful that the above responses provide additional clarification and we welcome any feedback in helping to make this a successful program.

Sincerely,

Iris Payne

Iris Payne, CDBG Director

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OIG Evaluation of Auditee Comments

Comment 1 The Department asserted that (1) not having grant activity does not negate the processing of subrecipients' reimbursements for any outstanding payments incurred, (2) there was no clear timeframe for deobligating funds, and (3) the law governing NSP allows funds to be available until spent. However, it stated that it would notify all subrecipients and deobligate funds.

We acknowledge the Department's willingness to deobligate NSP1 funds. The Department should work with HUD during the audit resolution process to ensure that any deobligated funds are reprogrammed to other subrecipients using an appropriate method.

Comment 2 The Department stated that, based on its policies and procedures, it reserved the right to adjust contracted grant amounts based on progress and performance. It also explained that the reallocation in question was awarded to a subrecipient that met all NSP requirements for its first project and received the North Carolina Housing Award of Excellence. It further stated that the reallocation was based on a local government representative's request for additional funding. In addition, the Department stated that although the program regulations do not specify the deobligation and reallocation of funds, its goal was to reallocate all funds on hand to continue to provide additional housing stock to the citizens of North Carolina.

As stated in the report, the subrecipient was awarded NSP funds without a written justification. Although the policy and procedures referenced by the Department allowed awarding of funds based on progress and performance, the policy and procedures were not complete. Specifically, the Department did not have a written definition of a high performer. Regulations at 24 CFR 570.494(b)(2) state that recaptured funds should be obligated expeditiously. In addition, 24 CFR 570.490(a)(2) requires that funding decisions reached under the method of distribution, including all of the criteria used to award NSP funds, must be documented. Therefore, the Department should work with HUD during the audit resolution process to ensure that a written policy and procedures are established and implemented and that $1.3 million in unsupported reallocation is adequately supported or reimbursed to the program.

Comment 3 The Department acknowledged that a portion of the documentation to support the administrative expenditures was not located at the time of our request. Specifically, the supporting documentation was misplaced due to staff turnover. However, the Department stated that the supporting documentation was available during HUD's monitoring visit in 2013. It stated that all funds drawn from Federal funds would be matched to the respective monthly report and a copy of any documentation would be attached to the report and filed for future audit reviews.

We acknowledge that the Department planned efforts to ensure that NSP expenditures would be documented and maintained for future audit reviews. The Department should work with HUD during the audit resolution process to ensure that (1) its records retention policy is updated to meet HUD's records retention requirements for supporting documentation for Federal program expenses and (2) more than $1.1 million in unsupported subrecipient and administrative expenditures is adequately supported or reimbursed to the program.

Comment 4 Regarding administrative salary expenses, the Department stated that it followed guidelines in Office of Management and Budget (OMB) Circular A-87 to provide time certifications to HUD's field office when requested. Further, in accordance with 2 CFR Part 200, the Department stated that it would continue to follow Circular A-87 until grant closeout for grants or costs before 2015.

As stated in the report, the Department provided only coding sheets without details broken out as documentation to support salary charges to the grants. In addition, OMB Circular A-87 provides that charges to Federal awards for salaries and wages must be based on timesheets to identify how employees spent their time on Federal grants. Therefore, the Department should work with HUD during the audit resolution process to ensure that the salary expenditures questioned in the report are adequately supported or reimburse the appropriate NSP grant from non-Federal funds. See recommendation 1D in the report.

Comment 5 The Department stated that until its process was automated, any employee working on more than one fund code would be required to submit a time and effort report at the end of each month. It further stated that once the process was automated, all employees paid from Federal funds received from HUD would be cost allocated to the grant through object time codes in the payroll system, along with time and effort report documentation.

We acknowledge the Department's planned action to allocate salary cost based on time spent on the program. The Department should work with HUD during the audit resolution process to fully implement the recommendations included in this audit report.

Comment 6 The Department provided details on how subrecipients reported NSP program income. Specifically, program income was now reported to the Department on a cumulative and monthly basis. In addition, during the reimbursement process, program income was spent before reimbursement from the line of credit. Further, the Department provided program regulations at 24 CFR 570.426, which related to program income after the closing of a grant.

Although the Department stated it was now receiving reports monthly as opposed to quarterly from the subrecipients, it was not explained or supported as such during our review. We were provided with and reviewed monthly reports submitted by the subrecipients. Further, the Department did not address the finding discussed in this report on varying amounts between what was reported to it by subrecipients and what it reported in HUD's grant tracking system and its quarterly performance reports. As stated in the report, HUD required the Department to report to HUD on its NSP funds via HUD's reporting system. Therefore, the Department should work with HUD during the audit resolution process to ensure that program income information is reconciled. Additionally, the Department should implement procedures and adequately train staff associated with administering the NSP grant to ensure the accurate reporting of program income. See recommendations 1F and 1G in the report.

Comment 7 Regarding activities meeting national objectives, the Department stated that it was working with its subrecipients to develop a plan to ensure that planned projects meet a national objective. It also stated that it expected to receive technical assistance from HUD with strategic focus on programmatic and system components and working toward closing out NSP projects. Further, the Department stated that it wanted to assure HUD that it had not and would not delay its monitoring of the subrecipients and would proceed with the closeout of the six activities identified in the audit report. Through its monitoring efforts, if the Department determined that a national objective could not be met, it would consider either transferring NSP funds to its regular Community Development Block Grant program or returning the funds to the U.S. Treasury.

We acknowledge the Department's effort to receive technical assistance to ensure that activities meet national objectives and to close out the NSP grant. The Department should work with HUD during the audit resolution process to fully implement the recommendations included in this audit report.

Comment 8 The Department requested that the audit report include a recommendation that technical assistance be provided by HUD regarding the six activities mentioned in our report.

The report recommends that the HUD field office work with the Department in developing a remediation plan to ensure that the activities meet a national objective. However, we revised the recommendation to specify the six activities. See recommendation 1I in the report.