Issue Date
December 18, 2007
Audit Report Number
2008-FW-1004

TO: John T. Maldonado
Director, Community Planning and Development, 6JD

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: Community Development Corporation of Brownsville, Brownsville, Texas, Did Not Use Its Housing Counseling Grants for the Intended Purpose

HIGHLIGHTS

What We Audited and Why

We audited the Community Development Corporation of Brownsville, Inc. (Corporation), at the request of the U. S. Department of Housing and Urban Development's (HUD) San Antonio Director of Community Planning and Development.

Our objective was to determine whether the Corporation correctly charged administrative costs to its various federal funding sources. We expanded our objective to also determine whether the Corporation used housing counseling grant funds to qualify mortgage applicants instead of counseling potential homebuyers.

What We Found

The Corporation used part of its housing counseling grant funds for qualifying mortgage applicants. This condition occurred because the Corporation has a prohibited conflict of interest as it provided housing counseling, mortgage qualifying, and underwriting services. As a result, it charged $177,139 in ineligible salaries and $80,647 in unsupported fringe benefits to its grants.

In addition, the Corporation did not allocate general administrative costs in proportion to the relative benefits received by the various funding sources or awards, which resulted in unsupported costs of $391,313. Further, it could not support a $472,069 increase in its building acquisition cost or the $66,000 value assigned to the land because it did not follow federal requirements and generally accepted accounting principles (GAAP). As a result, it may have overcharged its federal funding sources or awards by as much as $67,210 for depreciation. The improper allocation of costs and overcharging occurred because the Corporation did not fully understand or follow federal requirements and GAAP.

What We Recommend

We recommend that the Director of Community Planning and Development require the Corporation to resolve its conflict of interest between counseling potential homebuyers and selling them and/or financing their home and repay to HUD $177,139 in ineligible salaries and support or repay $80,647 in fringe benefits charged to the housing counseling grant funds. In addition, the Director should require the Corporation to develop a cost allocation plan that allocates general administrative expenses relative to the benefits received by its funding sources or awards. The Corporation should submit the plan to HUD for approval and then reallocate the $391,313 in general administrative expenses. The Corporation should obtain an appraisal as of the date it purchased the building, have the appraiser value the building and land separately, adjust the values of the building and land, recalculate the depreciation, and reallocate the correct depreciation.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided our discussion draft report to the Corporation on November 5, 2007, and held the exit conference on November 13, 2007. We requested a written response by November 26, 2007, but granted the Corporation's request for additional time to respond. The Corporation provided a 22-page written response along with attachments on November 27, 2007. We did not include the entire response in the report because it was too voluminous, but it is available for review upon request. We summarized the response and provided our evaluation in Appendix B.

The Corporation disagreed with all three findings in the report, but did not provide any information that could refute the findings. Our conclusions remain unchanged; however, we reclassified some expenses in finding 1 from ineligible to unsupported based on the auditee's comments.

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BACKGROUND AND OBJECTIVES

The Community Development Corporation of Brownsville, Inc. (Corporation) was organized in 1974 to provide affordable housing to the Brownsville area. The Corporation is located at 901 East Levee Street, Brownsville, Texas. It built and/or financed 556 affordable homes and provided downpayment assistance to 372 families during the audit period. It was approved as a Federal Housing Administration direct endorsement lender on November 20, 1995.

The Corporation generates revenue by selling houses; earning lending and servicing fees; selling individual building sites that were either purchased in bulk or developed; providing housing education to low- and moderate-income persons; and obtaining funding from federal, state, local, and private sources. It had gross revenues of $6.6 million in 2006, of which more than $1.8 million was from federal sources (see appendix C). It had gross revenues of $6.9 million and $11.3 million in 2005 and 2004, respectively.

The U. S. Department of Housing and Urban Development (HUD) Office of Community Planning and Development, San Antonio, Texas, office, and the City of Brownsville have had concerns regarding the Corporation for many years. Due to the ongoing problems, HUD's San Antonio Director of Community Planning and Development requested that we audit the Corporation's method of allocating costs.

Our objective was to determine whether the Corporation correctly charged administrative costs to its various funding sources between October 1, 2003, and September 30, 2006. We expanded our objective to also determine whether the Corporation used housing counseling grant funds to qualify mortgage applicants instead of counseling potential homebuyers.

RESULTS OF AUDIT

Finding 1: Housing Counseling Grants Were Inappropriately Used to Qualify Applicants

The Corporation used housing counseling grant funds to qualify mortgage applicants instead of offering advice to potential homebuyers and renters as required by HUD. This condition occurred because of a conflict of interest and resulted in $177,139 in ineligible salaries and $80,647 in unsupported fringe benefits.

The Corporation Had a Conflict of Interest

The Corporation had a conflict of interest. It offered its clients counseling services; sold them homes, which it developed and built; and provided financing. HUD's Housing Counseling Handbook states that HUD considers a conflict to exist when the counseling agency has any interest in the matter relating to the client or an interest that might compromise the agency's ability to represent fully the best interests of the client. It further states that a conflict of interest exists whenever the agency owns or purchases a property that the client seeks to rent or chooses to rent or owns or purchases the property that the client seeks to purchase or chooses to purchase.

Counseling Funds Were Used to Find and Qualify Loan Applicants

The Corporation improperly charged its housing counseling grants $177,139 in salaries for employees, other than housing counselors, whose purpose was to qualify mortgage loan applicants. The purpose of HUD's Housing Counseling Assistance Program is to offer advice to potential homebuyers and renters, not to find and qualify mortgage loan applicants or sell houses. In addition, the Corporation could not support $80,647 in fringe benefits paid for employees. The objective of the counseling program is to increase participation of first-time homebuyers and reduce mortgage defaults and foreclosures. To reach these program objectives, counseling agencies perform outreach, education, and followup.[1]

The Corporation did not fully understand or follow HUD's Housing Counseling Assistance Program requirements. Its executive director explained that only one out of ten families that the Corporation served qualified for a mortgage loan. The

1 HUD Handbook 7610.1, REV-4, CHG-2, Housing Counseling Program Handbook.

Corporation used the housing counseling grant to pay the costs associated with families that did not qualify. The executive director stated that the Corporation operated the same as other housing counseling agencies. However, we contacted three housing counseling agencies in the region, which stated that they did not sell to or finance homes for their clients.

We attributed the improper use of housing counseling funds for mortgage loan processing to a conflict of interest. The Corporation used the funds to qualify mortgage applicants instead of offering advice to potential homebuyers and renters.

Recommendations

We recommend that the Director of Community Planning and Development require the Corporation to

1A. Resolve the conflict of interest before it spends any more housing counseling grant funds.

1B. Repay $177,139 to HUD from nonfederal funds for ineligible salaries.

1C. Provide support for $80,647 paid for fringe benefits or repay to HUD from nonfederal funds any unsupported costs.

Finding 2: The Corporation Did Not Equitably Allocate Administrative Costs

The Corporation did not allocate $391,313 in general administrative costs in proportion to the relative benefits received by the various funding sources or awards. The improper allocation of costs occurred because the Corporation did not fully understand or follow federal requirements.

Methods of Allocating Costs to Federal Grants

According to federal requirements,[2] there are two types of cost, direct and indirect. Direct costs can be identified specifically with an award. Indirect costs are incurred for common or joint costs and cannot be readily identified with just one award. Indirect costs are classified as either “facilities” or “administration.” Nonprofits can allocate indirect costs using several different methods including simplified, multiple base, direct, and negotiated rate. Nonprofits must prorate indirect costs using a base which accurately measures the benefits provided to each funding source or award. The base must be established in accordance with reasonable criteria and be supported by current data.

The Corporation’s Allocation Method

The Corporation submitted several cost allocation plans to HUD, but none of the plans were approved. It treated all costs as direct costs, except for some facilities and administration costs. It used building square footage as the base to allocate facilities and administrative costs. It used two methods to assign square footage. First, it identified the square footage related to specific funding sources or awards, a method that met federal requirements. Second, it assigned the common and administrative area costs equally to the funding sources, irrespective of the benefits provided to each funding source, a method that did not meet federal requirements. As a result, the Corporation may have overcharged the various funding sources a total of $391,313. We were unable to determine the amount charged to the housing counseling grant. However, the space used for the program was minimal when compared to that used for other programs.

The Corporation’s current cost allocation plan does not properly allocate some general administrative expenses relative to the benefits received by its funding sources. The improper allocation of costs occurred because the Corporation did not fully understand or follow federal requirements.

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[2] Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations.

Recommendations

We recommend that the Director of Community Planning and Development require the Corporation to

2A. Develop a cost allocation plan that allocates general administrative expenses relative to the benefits received by its funding sources and submit the plan to HUD for review and approval.

2B. Reallocate the $391,313 in general administrative expenses in accordance with the approved plan and submit the reallocation results to HUD for review and approval.

2C. Refund any overcharges to the appropriate federal agency or grant.

Finding 3: The Corporation May Have Overcharged Its Funding Sources for Building Depreciation

The Corporation may have overcharged depreciation expense and could not support its building acquisition cost because it did not follow federal requirements and generally accepted accounting principles (GAAP) in accounting for the building purchase. As a result, the Corporation may have overcharged $67,210 in depreciation expense and could not support an increase of $472,069 in the building acquisition cost or the $66,000 value assigned to the land.

The Corporation Purchased and Then Valued the Building

The Corporation purchased its main office building in September 2000 for $175,000. In 2002, it had the building appraised for $660,000. The appraiser did not separate the land and building values. At that time, the Corporation increased the recorded value of the building by $472,069 and allocated $66,000 to the land. It stated that the increase in value was due to the seller of the property claiming a charitable contribution for the difference between the original sales price and the appraised value.

The Corporation was required to follow Office of Management and Budget Circular A-122, which requires costs to be determined in accordance with GAAP. When an asset is aquired, GAAP requires that its value be recorded at cost. GAAP also requires that charitable contributions received be recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses, depending on the form of the benefits received. Contributions received shall be measured at their fair values.[3]

The Corporation indicated that a charitable contribution was part of the original sale transaction. However, the charitable contribution was not properly recorded as the Corporation did not understand federal requirements. If a charitable contribution occurred on the date of the sale, the Corporation should have obtained an appraisal when it purchased the building and recorded it appropriately. Further, the appraiser should have placed a separate value on the land and building. However, the facts surrounding the sale, the charitable contribution, and the Corporation's increase in the value appear questionable. For example, the charitable contribution letter from the seller was undated, but it contained 2002 appraisal information. The Corporation began depreciating the increased value of the property in 2003, but the sale was recorded in 2000. We question the additional depreciation charges of $67,210.

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[3] Statement of Financial Accounting Standards No. 116, Accounting for Contributions Received and Contributions Made.

The Corporation purchased its office building in 2000 for $175,000 and obtained an appraisal in 2002 showing the building valued at $660,000. The Corporation then claimed that, at the initial purchase, the seller intended to make a contribution to the Corporation for the difference between the original sales price and the appraised value. This does not comply with GAAP.

Recommendations

We recommend that the Director of the Office of Community Planning and Development require the Corporation to

3A. Provide evidence to HUD that a charitable contribution occurred on the date of the building purchase.

3B. If HUD agrees that a charitable contribution occurred on the date of purchase, obtain an appraisal that separately values the building and land, as of the date of purchase, and make adjustments to depreciation, if necessary, based on the appraisal.

3C. If HUD determines that a charitable contribution did not occur on the date of purchase, depreciate the building based on its cost. Depending on the method of depreciation HUD allows, the unsupported depreciation expense could be as much as $67,210.

SCOPE AND METHODOLOGY

We audited the Corporation, located at 901 East Levee Street, Brownsville, Texas. Our audit covered the period from October 1, 2003, to September 30, 2006. We conducted the audit from February 20 to June 7, 2007.

To accomplish our audit objective, we

- Planned the survey and audit.

- Interviewed the chairman of the Rio Grande Valley MultiBank, three other regional housing counselors, a local builder, HUD and Corporation staff, and a former Corporation employee.

- Reviewed Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations; Statement of Financial Accounting Standards No. 116, Accounting for Contributions Received and Contributions Made; applicable housing counseling grants; and HUD Handbook 7610.1, REV-4, CHG-2, Housing Counseling Program Handbook.

- Reviewed HUD and Corporation correspondence, the Corporation's audited financial statements, HUD monitoring reports, and an agreed-upon procedures report from the Corporation's auditors.

- Reviewed the September 3 and 10, 2006, payroll records for two employees to gain an understanding of the system.

- Reviewed a sample of 20 of 1,064 housing counseling files randomly selected by EZ-Quant to gain an understanding of the system.

- Reviewed the Corporation's direct cost allocation plan and documents and transactions pertaining to the Corporation's building purchase.

- Performed other tests as necessary to accomplish our objectives.

We did not conduct an in-depth review of the reliability of the Corporation's computer-processed data because we only used the data for background purposes. We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Cash receipts,
- Purchasing,
- Accounts payable,
- Cash disbursements,
- Payroll,
- Property and equipment,
- Systematic organization,
- Written procedures, and
- Direct cost allocation plan.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Housing counseling grants were used to qualify borrowers due to a conflict of interest (see finding 1).
- The Corporation did not equitably allocate administrative costs (see finding 2).

- The Corporation could not support an increase in its building acquisition cost or the value assigned to the building's land (see finding 3).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1B	$177,139	
1C		$ 80,647
2C		391,313
3A		67,210
Totals	$ 177,139	$ 539,170

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

2/ 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 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

COMMUNITY DEVELOPMENT
CORPORATION OF BROWNSVILLE

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Tel. (956) 541-4955
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www.cdcb.org

November 27, 2007

Mr. Gerald R. Kirkland
Regional Inspector General for Audit 6AG-A
U.S. Department of Housing & Urban Development
Region VI - Office of Inspector General
819 Taylor Street - Room 113A09
Fort Worth, Texas 76102

Dear Mr. Kirkland:

Please find enclosed the response of the Community Development Corporation of Brownsville Inc. to the draft report issued by the Office of Inspector General on November 5, 2007.

At the Exit Conference on November 13, 2007, the Community Development Corporation of Brownsville presented Mr. Mike Hall, Senior Auditor, and Jake Williams, Acting Assistant Regional Inspector General, backup documentation related to the three findings. CDCB also provided clarifying information as regards to Findings Two and Three, specifically related in Finding Two related to the $391,313.00 figure quoted in the "draft report" relative to the dollars actually attributable based on OIG's own "34 areas" workpapers. It was our understanding this Finding would be substantially modified, and that Finding Three "would disappear".

CDCB has since been notified by email from Mr. Jake Williams that "no substantive modifications were being made to the "draft report". Therefore, we are again providing backup documentation related to the findings that have already been presented to your representatives at the Exit Conference.

We look forward to working with the Office of the Inspector General to resolve any findings that may remain after the final report has been issued.

Should you have any questions or concerns, please do not hesitate to contact me at (956) 541-4955 or via email at dcurrie@cdcb.org.

Sincerely yours,

Don Currie
Executive Director

We did not include the remaining 21 pages of the auditee's comments or the attachments because they were voluminous. They are available for review upon request. Following is a summary of the comments and OIG's evaluation of the comments.

Comment 1 The Corporation believed that it did not have a conflict of interest because HUD had reviewed its Housing Counseling program every two years since 1991 and had unconditionally approved it. The Corporation pointed out that HUD used a monitoring form that contained specific questions concerning conflict of interest, and that no conflict of interest was noted. In addition, the Corporation claimed that it had no conflict of interest because it was not a seller of homes, a builder of homes except for self-help program homes, and did not sell homes it developed and built to clients that it counseled.

OIG Evaluation: The Corporation had a conflict of interest. Its audited financial statements list "Home and Lots Sales" as the Corporation's primary source of revenue. In addition, HUD did not conclude that the Corporation was free of a conflict of interest. HUD's monitoring report did not include whether a conflict of interest existed, only that the Corporation used lending staff for part-time counseling on specific days. HUD considers a conflict to exist when the counseling agency has any interest in the matter relating to the client, and interest that might compromise the agency's ability to represent fully the best interests of the client. HUD provides specific circumstances in which a conflict exists, including selling a client a home and holding or servicing the mortgage on the client's property, both of which the Corporation does.

Comment 2 The Corporation disagreed with the ineligible costs totaling $257,787 because the figure included eligible costs. It argued that OIG included $9,684 in fringe benefits associated with allowable employee salaries, $60,965 in allowable administrative salaries and benefits, and $24,186 in unreimbursed funds.

OIG Evaluation: We reclassified the questioned costs to $177,139 of ineligible salaries and unsupported fringe benefits of $80,647. We also added a recommendation for the Corporation to provide support for $80,647 paid for fringe benefits or repay to HUD from nonfederal funds any unsupported costs. We recognize that the Corporation may not have been fully reimbursed and the Field Office may take this into account.

Comment 3 The Corporation disagreed with the unsupported costs totaling $391,313 because it was the sum of all expenses, including direct, administrative, Youthbuild, amounts paid from the Corporation's unrestricted funds and common area expenses.

OIG Evaluation: We based the unsupported costs on information supplied by the Corporation. The Corporation's expenses allocated by square footage included telephone, postage meter rental, software upgrades, maintenance agreements, security, copier lease, internet, office and cleaning supplies, and utilities. We did not include all direct expenses (i.e. postage, consulting, accounting, legal, audit and insurance).

Comment 4 The Corporation disagreed with our conclusion that it could not support an increase in a building acquisition cost and a land valuation. It claimed that it had complied with HUD requirements and GAAP concerning the appreciation of the building. It disagreed that it might have overcharged depreciation expense by $67,210 because its auditors had confirmed the depreciation and building value.

OIG Evaluation: The Corporation did not comply with HUD requirements or GAAP. The Corporation did not value the building at the time of acquisition, but waited until two years after the purchase. The appraisal district's value did not support the value in the Corporation's accounting records. The Corporation claimed $67,210 in depreciation expense based on the unsupported value of the building.

Appendix C

The Corporation's Funding Sources for Fiscal Year 2006

COMMUNITY DEVELOPMENT CORPORATION OF BROWNSVILLE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED SEPTEMBER 30, 2006

Federal/Pass-Through Grantor Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Expenses
FEDERAL AWARDS			
U.S. Department of Agriculture			
Direct Programs			
Rural Housing Service:			
Rural Housing Site Loans and Self-Help Housing Land Dev. Loans	10.411	NA	$ 3,432
Self-Help Technical Assistance Agreement (RD 523)	10.411	NA	27,077
Total U.S. Department of Agriculture Direct Programs			30,509
U.S. Department of Housing and Urban Development			
Direct Programs			
Community Planning and Development:			
Opportunities for Youth - Youthbuild Program (YB04)	14.243	NA	248,966
Rural Housing and Economic Development (RH03)	14.250	NA	196,266
Total Community Planning and Development			445,232
Housing:			
Housing Counseling Assistance Program (49) HC 05-0895-005	14.169	NA	25,000
Housing Counseling Assistance Program (49) HC 05-0897-001	14.169	NA	40,000
Housing Counseling Assistance Program (49) HC 05-0898-068	14.169	NA	34,689
Total Housing			99,689
Total U.S. Department of Housing and Urban Development Direct Programs			544,921
Passed Through Cameron County, Texas			
Community Development Block Grant -Self-Help Program (Self 2)	14.228	716003	317,161
Total Passed Through Cameron County			317,161
Passed Through Texas Department of Housing and Community Affairs			
HOME Investment Parternships Program (1000313) (ST100)	14.239	1000313	380,000
Bootstrap Program	14.239	853300	315,778
Total Passed Through Texas Department of Housing and Community Affairs			695,778
Total U.S. Department of Housing and Urban Development			1,557,860
U.S. Department of Labor			
Passed Through Youthbuild USA:			
Department of Labor - Youthbuild Agreement (04-05)	14.243	NA	25,525
Department of Labor - Youthbuild Agreement (05-06)	14.243	NA	84,906
Americorps- Youthbuild USA (05-06)	14.243	NA	109,419
Americorps- Youthbuild USA (06-07)	14.243	NA	8,505
Total Passed Through Youthbuild USA			228,355
Total U.S. Department of Labor			228,355
Total Direct Programs			575,430
Total Federal Awards			$ 1,816,724