



Issue Date	June 5, 2012
Audit Report Number	2012-LA-1007

TO: William Vasquez, Director, Office of Community Planning and Development,  
9DD

//Signed//

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region  
IX, 9DGA

SUBJECT: Los Angeles Neighborhood Housing Services, Los Angeles, CA, Did Not  
Always Properly Administer Its NSP2 Grant

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the Los Angeles Neighborhood Housing Services' Neighborhood Stabilization Program 2 (NSP2). We performed the audit because American Recovery and Reinvestment Act of 2009 reviews are part of the Office of Inspector General's (OIG) annual plan and Neighborhood Housing Services was awarded \$60 million in Recovery Act NSP2 funds in a consortium agreement with 12 other organizations on February 11, 2010.

Our audit objective was to determine whether Neighborhood Housing Services monitored its consortium members and ensured that its NSP2 expenditures were eligible and supported.

### **What We Found**

Neighborhood Housing Services did not implement internal controls to monitor its consortium members or ensure that its NSP2 expenditures were eligible and supported. Its policies and procedures for property acquisition and rehabilitation

were effective; however, its policies for disbursements and expenditures, as well as its monitoring of consortium members, were ineffective. Neighborhood Housing Services' inadequate internal controls resulted in no reconciliation of its NSP2 drawdowns to its expenditures, instances of improper payments to a consortium member and other vendors, an ineffective internal audit function, and no assurance that consortium members performed the NSP2-funded activities.

### **What We Recommend**

We recommend that the Director of the Los Angeles Office of Community Planning and Development require Neighborhood Housing Services to (1) reconcile all NSP2 drawdowns to the expenses funded and repay any funds drawn for duplicate or non-NSP2-eligible expenses from non-Federal funds; (2) implement written procedures to ensure that its finance department follows all Federal regulations, including but not limited to ensuring that all drawdowns are tracked to the related expenditures and the U.S. Department of Housing and Urban Development's (HUD) Disaster Recovery Grant Reporting system accurately reflects the amounts expended for each NSP2 activity; (3) implement written procedures to establish an effective internal audit function; (4) support the \$30,000 paid to its consortium member or repay the amount from non-Federal funds; (5) repay the duplicate payment of \$15,625 from non-Federal funds; and (6) revise and implement its monitoring policies and procedures to include monitoring all consortium members.

For each recommendation in the body of the report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided Neighborhood Housing Services a discussion draft report on May 4, 2012, and held an exit conference on May 17, 2012. Neighborhood Housing Services provided written comments on May 29, 2012, and generally disagreed with our finding.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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## **BACKGROUND AND OBJECTIVES**

Los Angeles Neighborhood Housing Services, Inc., was incorporated in 1984 to promote the restoration and revitalization of certain neighborhoods within the city of Los Angeles, CA. Neighborhood Housing Services provides an array of services to improve social and physical conditions in targeted neighborhoods. Core services include financial literacy education, acquisition and rehabilitation of distressed property, affordable lending programs, and technical assistance to homeowners who do not meet traditional commercial credit requirements. Neighborhood Housing Services is organized to serve Los Angeles County.

The Neighborhood Stabilization Program 2 (NSP2) was authorized under Title XII of Division A of the American Recovery and Reinvestment Act of 2009 and provided 56 grants nationwide on a competitive basis totaling \$1.93 billion. NSP2 was established to stabilize neighborhoods the viability of which has been and continues to be damaged by the economic effects of properties that have been foreclosed upon and abandoned. The NSP2 grant recipients included 37 consortiums, 3 nonprofits, 15 local government entities, and 1 State. These grantees were selected on the basis of foreclosure needs in their selected target areas, recent past experience, program design, and compliance with NSP2 rules.

The U.S. Department of Housing and Urban Development (HUD) awarded \$60 million in NSP2 funding to Neighborhood Housing Services and executed a grant agreement with it on February 11, 2010. According to Neighborhood Housing Services' NSP2 grant application, it proposed to establish and lead a consortium with 12<sup>1</sup> other organizations that would carry out a broad range of community development activities, including the acquisition and rehabilitation of single-family homes and residential properties, downpayment assistance, and administrative activities, including \$150,000 for home-buyer counseling. Neighborhood Housing Services budgeted its NSP2 funds to itself and its consortium members<sup>2</sup> as follows:

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<sup>1</sup> Neighborhood Housing Services' NSP2 grant application provided for a consortium of itself and 12 other organizations; however, it executed consortium agreements with only 9 other organizations.

<sup>2</sup> One of Neighborhood Housing Services' consortium members, Watts Century Latino Organization, was not specifically included in its NSP2 budget; however, it paid Watts for its home-buyer counseling services from its \$6 million budgeted administrative costs.

Responsible entity	Activity and budgeted NSP2 funds				Totals
	Single-family acquisition and rehabilitation	Multifamily acquisition and rehabilitation	Down-payment assistance	Administrative costs	
<b>Asian American Drug Abuse Program</b>					
		\$920,000			<b>\$920,000</b>
<b>ANR Industries, Inc.</b>					
	\$125,000				<b>\$125,000</b>
<b>City of Carson</b>					
	\$1,000,000		\$1,000,000		<b>\$2,000,000</b>
<b>City of Compton</b>					
	\$3,000,000		\$1,000,000		<b>\$4,000,000</b>
<b>City of Inglewood</b>					
	\$500,000		\$250,000		<b>\$750,000</b>
<b>Los Angeles Neighborhood Housing Services</b>					
	\$16,575,000	\$2,900,000	\$15,100,000	\$6,000,000	<b>\$40,575,000</b>
<b>Search to Involve Pilipino Americans</b>					
		\$5,500,000			<b>\$5,500,000</b>
<b>Vermont Slauson Economic Development Corporation</b>					
	\$187,500	\$1,680,000			<b>\$1,867,500</b>
<b>Vermont Village Community Development Corporation</b>					
	\$262,500	\$4,000,000			<b>\$4,262,500</b>
<b>Totals</b>	<b>\$21,650,000</b>	<b>\$15,000,000</b>	<b>\$17,350,000</b>	<b>\$6,000,000</b>	<b>\$60,000,000</b>

The grant agreement required Neighborhood Housing Services to expend 50 percent of the grant by February 11, 2012, and expend 100 percent of the grant by February 11, 2013. However, it had expended only 45.08 percent of its grant as of its 50 percent expenditure deadline on February 11, 2012. As a result, HUD placed it on a workout plan. As part of the workout plan, Neighborhood Housing Services was required to submit a written plan detailing how it would meet the 100 percent expenditure requirement by February 2013, with one condition being that it was required to accept technical assistance that would evaluate the viability of its proposed plan for its NSP2 funds. At the time of our audit report, the Los Angeles Office of Community Planning and Development and HUD headquarters in Washington, DC, were awaiting the results of the technical assistance.<sup>3</sup>

According to Neighborhood Housing Services, before receiving the NSP2 grant, it had received approximately \$322,000 in HUD-related funding annually as a subrecipient through NeighborWorks America and local municipalities.

Our audit objective was to determine whether Neighborhood Housing Services monitored its consortium members and ensured that its NSP2 expenditures were eligible and supported.

<sup>3</sup> Since HUD was addressing the matter, we did not pursue or identify the issue as a finding.

## RESULTS OF AUDIT

### Finding: Neighborhood Housing Services Did Not Ensure That Its NSP2 Expenditures Were Always Eligible and Supported or Monitor Its Consortium Members

Neighborhood Housing Services' policies and procedures for its NSP2 disbursements and expenditures, as well as its monitoring of consortium members, did not ensure compliance with regulations. Specifically, Neighborhood Housing Services did not reconcile its NSP2 drawdowns to its expenditures, made improper payments to a consortium member and other vendors, did not develop an effective internal audit function, and did not always monitor its consortium members. It was not always aware of its responsibilities as a HUD grantee under NSP2 and did not know that it needed to monitor all of its consortium members. As a result, there was a risk that its NSP2 drawdowns may not have been for eligible and supported expenditures in all cases. In addition, more than \$45,625 in questionable expenditures could have been used for other eligible NSP2 activities, and there was no assurance that consortium members performed the NSP2-funded activities.

#### No Reconciliation of Drawdowns

For the most part, Neighborhood Housing Services was completing its single-family acquisition and rehabilitation activities in accordance with NSP2 regulations. However, it did not maintain sufficient documentation to support its draw requests, and it could not properly trace each of its drawdowns to the activities it funded. Neighborhood Housing Services was not able to match purchase rehabilitation expenses to HUD's Disaster Recovery Grant Reporting (DRGR) system funding drawdowns. While attempting to reconcile the drawdowns for our audit, it identified inaccurate properties, properties already identified under other draws, and properties not fully supported to the amounts drawn. As a result, we were not able to reconcile which properties had been funded with which draw or whether Neighborhood Housing Services drew funds for the same property multiple times.

This issue extended to Neighborhood Housing Services' administrative expenses. It did not keep track of which administrative expenses were funded with which drawdown. Further, it did not record administrative expenses as such in its accounting system. As a result, it could not provide a valid universe of NSP2 administrative expenses after three attempts, indicating a risk that administrative expenses were improperly recorded in HUD's DRGR system.

Historically, Neighborhood Housing Services drew its NSP2 funds based on estimated monetary needs in advance of spending the money, resulting in the drawn amounts not matching up with the actual amounts expended. Although this advance draw is allowed by NSP2 guidance, 24 CFR (Code of Federal Regulations) 84.21(b)(2) also requires recipients' financial management systems to provide for records that adequately identify the source and application of funds for federally sponsored activities. Neighborhood Housing Services did not revise the vouchers after expending the funds to appropriately record the actual amount expended or ensure that property acquisitions were ultimately recorded under the correct activity. For instance, it may have drawn money for its acquisition activities in one city but ultimately spent the money for a property in another city after the initial property was determined unfeasible, and it did not record this change in DRGR. As a result, DRGR may reflect inaccurate amounts for Neighborhood Housing Services' NSP2 activities.

Further, Neighborhood Housing Services could not show which NSP2 expenses the individual drawdowns were used for, and, ultimately, there was no assurance that the funds were spent on activities that were eligible and supported. Neighborhood Housing Services' staff members indicated that they were not aware of the requirement to identify the application of their NSP2 funds. Although Neighborhood Housing Services' practices could demonstrate that it spent its entire \$60 million NSP2 grant at the conclusion of its 3-year expenditure deadline, they did not provide assurance that it did not draw down twice for the same activity or fund ineligible activities during the 3-year period.

## **Improper Payments**

Neighborhood Housing Services paid \$30,000 to one of its consortium members for startup administrative costs and providing home-buyer education and counseling to families participating in its NSP2 program; however, it did not obtain documentation to support the performance of those activities. Under the applicable consortium agreement, the consortium member was required to report to Neighborhood Housing Services monthly (1) client demographic information and sign-in sheets for the participants in its home-buyer education program and (2) an outreach report including outreach materials, the number of participants reached, and a description of the geographic area targeted. However, Neighborhood Housing Services did not have any of the applicable documentation to support the \$30,000 payment to the consortium member.

Further, Neighborhood Housing Services made a duplicate payment of \$15,625 for professional service fees for June 2010. When we brought the duplicate payment to their attention, Neighborhood Housing Services staff members admitted to paying the June 2010 invoice twice and stated that they would obtain the \$15,625 from the vendor. Specifically, Neighborhood Housing Services planned to deduct the amount from future payments for work performed by the

vendor. However, this method did not guarantee that the money would be repaid to NSP2, as Neighborhood Housing Services may not have been netting it against invoices for NSP2 expenses.

In addition, Neighborhood Housing Services paid a duplicate payment of \$250 for lead remediation. However, the check had not been cashed, so staff members were able to issue a stop payment for the check after we brought it to their attention.

Lastly, Neighborhood Housing Services undercharged NSP2 by \$1,948 and \$10,989 for June 2010 and September 2011 salary expenses, respectively. It did not accurately record its salary expense for either month tested. The amounts charged to the program used inaccurate wages and allocation percentages for various employees and left out an employee. Although the expense was understated for the months in question, the lack of internal controls presented a risk that the expense could have been overstated during other periods.

### **Ineffective Internal Audit Function**

Neighborhood Housing Services' internal audit function was not in accordance with applicable criteria. Section (IV)(A)(3)(f) of the NSP2 notice of funding availability requires NSP2 recipients to have an internal audit function that "will continually examine potentially risky areas of program operations and management and provide regular and valuable feedback to program managers and to those who hold them accountable. This feedback will include identification of risky management practices and missing or ineffective internal controls, areas that are not in compliance with program requirements, and ineffective implementation of established policies." Neighborhood Housing Services was able to provide a list of consortium member meeting dates and meeting minutes, indicating that they met regularly to discuss the program through management meetings. However, the minutes focused primarily on NSP status updates rather than the internal audit function required by the notice. Further, given that Neighborhood Housing Services did not maintain sufficient documentation to support its draw requests and could not properly trace each of its drawdowns to the activities it funded, its internal audit function was not effective.

Neighborhood Housing Services staff members cited their internal controls as the organization's internal audit function. Those controls included having the chief financial officer, NSP2 program director, and NSP2 project manager monitor each step in the acquisition, rehabilitation, and resale of each property purchased and determining a property's feasibility for NSP2 before acquisition. Further, Neighborhood Housing Services used an outside contractor to provide quarterly monitoring of the consortium members that provided construction management services for the organization. However, it did not conduct an internal review of

its own finance department, from which the majority of the issues identified originated. Neighborhood Housing Services indicated that the outside contractor had not conducted a review of its finance department because it wasn't qualified for such a review, and despite HUD's suggesting that it hire an alternative contractor to review the finance department, Neighborhood Housing Services had not scheduled an internal audit of its finance department as of March 26, 2012. It said that it had not done so because none of the consultants HUD recommended had been available for it to schedule.

### **Incomplete Monitoring of Consortium Members**

Although Neighborhood Housing Services hired an outside contractor to provide quarterly monitoring of the consortium members performing construction management services, it had not monitored the remaining consortium members. It indicated that this was because it monitored only those consortium members that were paid construction management fees. However, not all consortium members were paid construction management fees. As detailed above, Neighborhood Housing Services paid \$30,000 to one of its consortium members without documentation to support the performance of NSP2-funded activities. Therefore, it should monitor all of its consortium members to ensure that they comply with their consortium agreements and earn any NSP2 funds paid, regardless of the type of fee.

In addition, Neighborhood Housing Services did not have sufficient written monitoring policies and procedures in place. Its grant application included a lengthy section on the grantee's intended monitoring plan and internal audit function, allowing it to take an active role in monitoring its consortium members. However, those intended plans had not been formalized in its NSP policies and procedures. Section III of its written monitoring procedures consisted of one sentence, generally stating that the "LA NHS [Neighborhood Housing Services] will perform on-site compliance and monitoring inspections of all single-family and multi-family developments utilizing NSP2 funds to determine compliance with the applicable regulations and requirements." A brief section on its requirements for subrecipients or development partners stated that Neighborhood Housing Services would "monitor Subrecipients (or Development Partners) to ensure the NSP2 funds are being used in accordance with all program requirements and that Subrecipients (or Development Partners) are adequately performing as required under subrecipient agreements and procurement contracts. If performance problems arise, LA NHS will take appropriate actions as described in 24 CFR 570.910." There was no detail regarding how the monitoring would be conducted, and the \$30,000 unsupported payment showed that monitoring did not always take place as set forth in the NSP2 policies and procedures.

## Finance Staff Turnover

Neighborhood Housing Services' lack of effective procedures and controls regarding the administration of the NSP2 funds was exacerbated by turnover among key finance staff members, including its chief financial officer and its NSP2 finance manager in 2011. In addition, two of the three other finance employees had worked at Neighborhood Housing Services less than a year. During audit fieldwork, its interim chief financial officer had trouble obtaining and interpreting information from previous periods due to the prior chief financial officer's practice of tracking information outside the accounting system.

## Conclusion

Neighborhood Housing Services did not reconcile its NSP2 drawdowns to its expenditures, made improper payments to its consortium members and other vendors, did not develop an effective internal audit function, and did not always monitor its consortium members. It was not always aware of its responsibilities as a HUD grantee under NSP2 and did not know that it needed to monitor all of its consortium members. The lack of effective procedures and controls regarding the administration of the NSP2 funds was exacerbated by turnover among key finance staff members. As a result, there was a risk that Neighborhood Housing Services' NSP2 drawdowns may not have been for eligible and supported expenditures in all cases. In addition, more than \$45,625 in questionable expenditures could have been used for other eligible NSP2 activities, and there was no assurance that consortium members performed the NSP2-funded activities.

## Recommendations

We recommend that the Director of the Los Angeles Office of Community Planning and Development require Neighborhood Housing Services to

- 1A. Reconcile all NSP2 drawdowns to the expenses funded and repay any funds drawn for duplicate or non-NSP2-eligible expenses from non-Federal funds.
- 1B. Implement written policies and procedures to ensure that its finance department follows all Federal regulations, including but not limited to ensuring that all drawdowns are tracked to related expenditures and DRGR accurately reflects the amounts expended for each NSP2 activity.
- 1C. Support the \$30,000 paid to its consortium member, showing activities performed, or repay the amount from non-Federal funds.

- 1D. Repay the duplicate payment of \$15,625 from non-Federal funds.
- 1E. Implement written procedures to establish an effective internal audit function.
- 1F. Revise and implement its monitoring policies and procedures to include the monitoring of all consortium members.

## SCOPE AND METHODOLOGY

We performed our onsite work at Neighborhood Housing Services' office located at 3926 Wilshire Boulevard, Suite 200, Los Angeles, CA, between October 2011 and March 2012. Our audit generally covered the period February 2010 through March 2012. We expanded our scope as necessary.

To accomplish our audit objective, we

- Obtained an understanding of the Recovery Act, Neighborhood Housing Services' grant agreements with HUD, and its planned activities for its NSP2 funds.
- Reviewed applicable HUD requirements.
- Reviewed relevant Neighborhood Housing Services policies and procedures for administering NSP2.
- Reviewed Neighborhood Housing Services' DRGR quarterly performance report and audited financial statements from fiscal years 2009, 2010, and 2011.
- Reviewed HUD's relevant monitoring report.
- Interviewed HUD officials from the Office of Community Planning and Development, Los Angeles field office, and Neighborhood Housing Services' supervisors and staff as appropriate.
- Reviewed job descriptions and the organizational charts for Neighborhood Housing Services.
- Selected a sample to test whether Neighborhood Housing Services conducted its NSP2 activities in accordance with HUD rules and regulations.
- Reviewed Neighborhood Housing Services' records pertaining to property acquisition, rehabilitation, resale, expenditures, and disbursements

We nonstatistically sampled 3 of 10 (30 percent) properties that were acquired and rehabilitated with NSP2 funds and sold as of the date of our sample selection. The three contracts reviewed were the properties with the highest acquisition costs for each of the three consortium members that provided construction management services to Neighborhood Housing Services for the sampled properties. In addition, we nonstatistically sampled 6 of 56 (10.7 percent) drawdowns for purchase and rehabilitation activities. The six drawdowns reviewed represented 16.3 percent of the total grant funds that had been drawn down at the time of our sample selection.

We were able to perform only limited testing of Neighborhood Housing Services' administrative expenses due to unreliable computer-processed data on the applicable universe (see finding). We

nonstatistically selected nine NSP2 administrative expense records from the questionable download of NSP2 administrative expense data. However, two of the nine expenses were not administrative expenses. The remaining seven expenses reviewed totaled almost \$511,071.

We chose our sampling approach since testing 100 percent of the population was not feasible. Therefore, the sampling results apply only to the items tested and cannot be projected to the universe or population.

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. 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:

- Implementation of policies and procedures to provide reasonable assurance that NSP2 program activities meet objectives and operations are effective and efficient.
- Implementation of policies and procedures to reasonably ensure that relevant and reliable financial information is obtained and fairly disclosed in reports.
- Implementation of policies and procedures to ensure that NSP2 activities are in accordance with applicable 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 Deficiencies

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

- Neighborhood Housing Services lacked internal controls to ensure compliance with Federal laws and regulations (see finding).
- Neighborhood Housing Services did not always monitor its consortium members (see finding).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1C		\$30,000
1D	\$15,625	

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 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.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments

May 28, 2012

Tanya E. Schulze  
Regional Inspector General for Audit  
Region IX  
611 West Sixth Street, Suite 1160  
Los Angeles, CA 90017-3101

Re: Response to draft audit report for NSP2

Dear Ms. Schulze,

Per the exit conference held with your staff regarding the IG audit of the Los Angeles Neighborhood Housing Services (NHS) and its monitoring of the NSP2, we have prepared a response to the audit findings. As noted at the meeting, in general we found the audit draft accurately reflected some of the issues faced by NHS and its consortium members in implementing the program. However, we also found that there were inaccuracies noted in the report by the IG staff which we have documented as a part of our formal comments and would like to have included in the report.

Finding: Neighborhood Housing Services Did Not Ensure That Its NSP2 Expenditures  
Were Always Eligible and Supported or Monitor Its Consortium Members

The finding refers to NHS activities on a broad scale versus some of the specific issues that may have been found during a specific time period of NHS implementing NSP2. During the time period of the IG audit, NHS had several instances of improper reconciliations, one overpayment to a vendor, and one consortium member that needed improved monitoring. NHS also provided extensive internal audit functions in every area except the Finance unit, which it requested technical assistance support from HUD. To date, that assistance has not been provided, and each of the suggested consultants recommended by HUD have not been available to assist in this audit area.

A. No Reconciliation of Drawdowns

The period discussed in the audit results covers February 2010 to March 2012. However, the IG audit team focused the major portion of its testing on the 2010 calendar year and early administrative portion of the NSP2 effort. NHS had limited knowledge and experience in administering the program during that time period, and the DRGR has significantly changed since that time as well. NHS has subsequently instituted the following controls:

- 1) No draws are initiated as an advance for the program or without all of the proper documentation from local vendors, contractors or internal reconciliations. Drawdowns are only submitted through the DRGR when accompanied by an approved draw request attached to a purchase contract or vendor invoice.

**Comment 1**

**Comment 2**

- 2) In the event that the acquisition cannot be completed after it has been submitted to DRGR, the NSP2 Finance Manager will go back into DRGR and de-obligate the funds for that draw.
- 3) All documentation for draws is reviewed and approved by the NHS Chief Financial Officer, prior to submission to the NHS President & CEO for submission approval through DRGR.

**Comment 3**

NHS provided multiple source documents that reflected proper usage of NSP2 funds and expenditures, and that in fact, NHS had not charged substantial costs to the program service delivery area that were allowable. It is our belief that the most significant issue was that NHS had been “undercharging” the true costs of the Program, and that the Administrative budget (and NHS’ own financial resources) had been overcharged for numerous costs that should have been charged to program delivery costs. NHS has initiated a cost recovery project so that incurred expenses can be properly recorded.

**B. Improper Payments**

NHS has worked diligently to provide hundreds of payments to approved contractors, vendors and Consortia members in its management of the NSP2. Given the high volume of payments, and some staff turnover, NHS experienced several improper payments.

**Comment 4**

1. The IG audit found that there was a lack of documentation for a \$30,000 expenditure to one consortium member, WCLO for homebuyer education services. The documentation of usage by WCLO for \$30,000 expended from NSP2 funds was provided to [REDACTED] and [REDACTED] at the time of the exit interview. It should be noted that NHS made numerous attempts to collect the appropriate documentation from this Consortium member and had significant difficulty obtaining the information until now. In addition, NHS had planned to expend up to \$150,000 with this Consortium member, but ended up only expending \$30,000 because the member had not provided adequate documentation. Therefore, some of our monitoring efforts worked, but could have been improved upon.

NHS effectively monitored all of its other Consortium members and conducted ongoing audits of their work efforts. For any members who did not meet the agreed upon contract requirements, their funding was de-obligated, and future production under NSP2 cancelled. NHS then covered the obligatory requirements and has had success in completing the required production elements.

**Comment 2**

2. NHS made a duplicate payment to one vendor for professional services rendered. NHS plans to repay the duplicate payment out of non-NSP2 funds. NHS also initiated collection efforts from the vendor and is awaiting repayment. To avoid duplicate payments, NHS’ Finance Department no longer pays invoices that are not original invoices. All payments must be made from an original invoice (no copies are accepted for payment).

**Comment 2**

3. Additionally, invoices are logged into the system by invoice date *and* invoice number.

\*Names redacted for privacy reasons

**Comment 2**

As noted previously, NHS consistently undercharged NSP2 for program delivery and administrative expenses. Despite the reference by the IG team that expenses “could have been overstated during other periods”, this was consistently proven to be false. NHS initiated its own expense reconciliation project while the IG was on site and consistently found that it was funding the NSP2 out of its own resources. During subsequent HUD monitoring visits, it was also found that NHS undercharged the NSP2 program on an ongoing basis.

**C. Ineffective Internal Audit Function**

**Comment 5**

The IG audit found that NHS’ internal audit function was not in accordance with applicable criteria. However, there was only one department (out of seven) within NHS that the IG team felt had failed to provide adequate internal audit controls. In fact, the others were well documented and in compliance. When NHS requested assistance from HUD to help with the Finance unit’s internal audit function, HUD suggested four consultants that were on their approved list to provide the audit function or technical assistance. To date, none of these approved consultants have been available to provide assistance. Therefore, NHS began its own internal audit of the Finance unit, and has subsequently hired a Quality Control and Compliance Manager to perform substantial internal audit functions.

NSP2 consortium meetings are held with the intent of giving members a forum to discuss issues and processes. These meetings were not held with the intent of being the venue for internal auditing.

**D. Incomplete Monitoring of Consortium Members**

**Comment 6**

The auditor’s comments in this section repeatedly quote regulations for “sub-recipients”. NHS has no NSP2 sub-recipients. NHS has Development Partner agreements with each of its consortia members. Further, comments were made that NHS should monitor all of its consortium members to ensure that they comply with their consortium agreements. NHS monitored all members who performed production contract work under the NSP2 program. There were three consortium members who performed no production contract work because they were researching potential multi-family property acquisitions. Their efforts have been well documented, and to date, neither NHS, nor its members have acquired any multi-family properties, nor has NHS paid these consortium members any production or contract fees.

It was suggested by both HUD staff and the IG audit team that NHS follow the policies and procedures set forth in its initial proposal. Accordingly, NHS has updated its NSP2 monitoring policies and NHS’ Finance staff is adhering to the written policies and procedures included with the original NSP2 proposal. The CFO is providing oversight to ensure compliance by staff.

**Comment 7**

NHS takes issue with the finding and conclusion drawn by the IG staff that describes our overall program effort as lacking NSP2 drawdown reconciliations and proper controls, uninformed, making improper payments and monitoring of consortium members and lacking the development of effective internal controls. While we agree that the financial management component of the NSP2 program needed improvement, NHS successfully implemented many critical components of the program that helped it to expend nearly \$30 million during the audit period.

**Comment 7**

When the IG team found one example of something, it then took a “broad brush” of the overall program without adequately representing the broad picture of the program effort. As was noted numerous times during the audit by the IG team, “we all have been learning the requirements

for implementing the NSP2 program”. Despite numerous obstacles, NHS and its consortium members have strived to accomplish the program goals and objectives.

NHS has implemented the following program improvements:

**Comment 8**

1A. The audit did not take into account the significant changes with the DRGR reporting system that subsequently allowed for NHS to better track its expenditures on a more detailed basis. NHS staff underwent significant DRGR training as the system was improved and now report on a detailed basis so that all NSP2 drawdowns are reconciled. NHS also initiated its own internal audit of NSP2 reconciliations and found that it had consistently undercharged the program for eligible NSP2 activities. NHS has begun the process of reconciling past drawdowns to bring all program charges to a current basis, and accurately reflecting the amounts expended.

**Comment 2**

**Comment 2**

1B. NHS has revised and implemented its written policies and procedures to ensure that its Finance team follows all Federal regulations.

**Comment 4**

1C. NHS provided the support documentation for the \$30,000 paid to its consortium member for activities performed for homebuyer education services.

**Comment 2**  
**Comment 9**

1D. NHS plans to repay the duplicate payment of \$15,625 from non-Federal funds and will provide the local HUD office with adequate documentation upon repayment.

**Comment 2**  
**Comment 4**

1E. NHS has revised and is implementing the written procedures required to provide effective internal audit functions and has hired a Quality Control and Compliance Manager. We have attached a sample internal control document as a further sample of our compliance review efforts.

1F. NHS has revised and is implementing its monitoring policies and procedures, and has already been monitoring all of its consortium members despite the IG’ comments to the contrary.

Thank you for your review and consideration of our formal comments.

Sincerely,

Lori R. Gay  
President & CEO

Cc:



## OIG Evaluation of Auditee Comments

- Comment 1** Our sample selections were based on the highest acquisition costs or expenses, as applicable (see Scope and Methodology). We did not focus our testing on any given time frame, other than our general scope, which was February 2010 through March 2012. The three properties we tested were acquired between September 2010 and April 2011 and sold between July and November 2011. The six drawdowns we tested were made between January and June 2011, and the seven administrative expenses we tested were dated between June 2010 and September 2011. Therefore, these sample items represent a total time period of June 2010 through November 2011, or 17 months.
- Comment 2** We acknowledge the Neighborhood Housing Services' proactive approach to implementing our recommendations and making other improvements; however, the auditee did not provide any documentation to support its assertions or revised procedures. HUD will evaluate Neighborhood Housing Services' adjustments and corrections as part of audit resolution.
- Comment 3** We acknowledge Neighborhood Housing Services provided source documents that reflected proper usage of NSP2 funds for the three properties we tested that were acquired and rehabilitated with NSP2 funds and sold as of the date of our sample selection. As we cited in our report, for the most part, Neighborhood Housing Services was completing its single-family acquisition and rehabilitation activities in accordance with NSP2 regulations. However, that does not excuse Neighborhood Housing Services from maintaining documentation to reconcile and support its draw requests.
- Comment 4** We had previously requested supporting documentation for the WCLO charges during the course of audit field work and Neighborhood Housing Services informed us it did not have documentation to support the performance of the applicable activities. The "Cost Analysis Report" was not provided by Neighborhood Housing Services until the exit conference. We reviewed this documentation and determined it was still insufficient to meet the requirements of the applicable consortium agreement. The Cost Analysis Report only included one of the elements required by the consortium agreement, indicating the number of outreach materials distributed. However, the report did not include any of the other required elements, including a basic client report including client demographic, financial, and area median income information; sign-in sheets for every home-buyer education class; the Neighborhood Housing Services home-buyer education survey; or an outreach report with outreach materials, the number of participants reached, and a description of the geographic area targeted. Therefore, Neighborhood Housing Services' monitoring of WCLO was insufficient and the amount remains unsupported.
- Comment 5** Neighborhood Housing Services told us during on-site audit field work that the same outside contractor used to monitor its consortium members had also

conducted internal reviews of Neighborhood Housing Services; however, despite repeated requests, it did not provide documentation of those reviews. Specifically, we requested documents pertaining to its internal audit function, noting that we had received copies of monitoring reports for its consortium members but nothing indicating Neighborhood Housing Services had reviewed its own internal practices. We did not specify any departments within the auditee's operations as part of this request. Neighborhood Housing Services then cited its internal controls as the organization's internal audit function, as stated in the audit report. We did not specifically determine the other six departments had adequate internal audit functions, as implied by the auditee's response. Our finding focused on the lack of internal review of the Neighborhood Housing Services' finance department because that was where the majority of the issues identified during the audit originated. Implementing an effective internal audit function is a step above and beyond the internal controls used to mitigate risk in day to day activities. There was no effective internal audit function in place at Neighborhood Housing Services outside of the monitoring conducted for some of its consortium members.

**Comment 6** The procedures we quoted that used the term "subrecipients" were taken from the Neighborhood Housing Services' NSP2 policies and procedures. As indicated by the Criteria Appendix C, the auditee's procedures use the term subrecipients multiple times within Section III, General Requirements of NSP2, although we do acknowledge the full context of the narrative includes "or Development Partners" in parenthesis after each mention of subrecipients, as indicated by the full criteria included within Appendix C. We initially excluded the "(or Development Partners)" within the narrative of our report for readability, but we have added that clarification to coincide with the full criteria outlined within the Appendix.

**Comment 7** We acknowledged the Neighborhood Housing Services' program successes throughout the audit report, as appropriate. For instance, we noted Neighborhood Housing Services was completing its single-family acquisition and rehabilitation activities in accordance with NSP2 regulations for the most part, that the auditee had hired an outside contractor to provide quarterly monitoring of some of its consortium members, and that auditee staff had taken a proactive approach to recoup improper payments as soon as we brought them to the staff's attention. However, we must present issues identified during the course of on-site audit field work. Our audit included assessing Neighborhood Housing Services' procedures and controls applicable to our audit objective and testing of a nonstatistical sample of items, since testing 100 percent of the universe of transactions was not practical (see Scope and Methodology). We believe the level of testing was sufficient to draw the conclusions discussed in the finding.

**Comment 8** We acknowledge that DRGR did not originally have a text field for the person setting up the drawdown voucher to enter notes to make reconciliation and tracking easier; however, DRGR has always allowed the person approving the

voucher to enter notes, as well as providing its users the ability to revise previously approved drawdowns to apply the funds for alternate activities.

**Comment 9** We did not receive the “sample internal control document” Neighborhood Housing Services intended to include with its response.

## Appendix C

### CRITERIA

Regulations at 24 CFR 84.21(b)(2) require recipients' financial management systems to provide for records that adequately identify the source and application of funds for federally sponsored activities. These records must contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income, and interest.

The notice of funding availability for NSP2 under the American Recovery and Reinvestment Act of 2009, Docket No. FR-5321-N-01, Section (IV)(A)(3)(f), requires

- NSP2 recipients to have an internal audit function that “will continually examine potentially risky areas of program operations and management and provide regular and valuable feedback to program managers and to those who hold them accountable. This feedback will include identification of risky management practices and missing or ineffective internal controls, areas that are not in compliance with program requirements, and ineffective implementation of established policies.”
- Community Development Block Grant grantees to have “a plan for monitoring all program activities and ensuring performance.”

The consortium funding agreement between Neighborhood Housing Services and its consortium member to which it paid the improper \$30,000 included a section on reporting requirements, including the requirement to conduct the following reporting activities:

- “HCO Report of participants of Homebuyer Education (HBE) Program – monthly
  - Basic client report including client demographic, financial, and AMI [area median income] information consistent with HUD 9902 report
  - Sign-in sheets for every HBE class
  - LA NHS HBE survey
- Outreach Report – monthly
  - Event details - including outreach materials and number of participants reached
  - Written material distribution - number of materials distributed and description of geographic area targeted.”

Neighborhood Housing Services' NSP2 Policies and Procedures, Section III, General Requirements of NSP2 - (I) Requirements for Subrecipients (or Development Partners), stated that Neighborhood Housing Services would “monitor Subrecipients (or Development Partners) to ensure the NSP2 funds are being used in accordance with all program requirements and that Subrecipients (or Development Partners) are adequately performing as required under subrecipient agreements and procurement contracts. If performance problems arise, LA NHS will take appropriate actions as described in 24 CFR 570.910.”

Neighborhood Housing Services' NSP2 Policies and Procedures, Section III, General Requirements of NSP2 - (V) Monitoring, read, "During the period of affordability, LA NHS will perform on-site compliance and monitoring inspections of all single-family and multi-family developments utilizing NSP2 funds to determine compliance with the applicable regulations and requirements outlined in this manual and NSP2 regulations."