Issue Date
May 29, 2008
Audit Report Number
2008-NY-1007

TO: Kathleen Naymola, Director, Community Planning and Development, 2FD

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: The County of Essex, Verona, N.J, Did Not Always Administer Its Community Development Block Grant Program in Accordance with HUD Requirements

HIGHLIGHTS

What We Audited and Why

We audited the County of Essex's (County) Community Development Block Grant (CDBG) program, which was administered by its Division of Housing and Community Development. We selected the County for review because of the size of its program, a high U.S. Department of Housing and Urban Development (HUD) risk analysis score, and indicators of unreported program income, Our audit objectives were to determine whether the County (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to HUD and applicable rules and regulations and (2) had a financial management system in place to adequately safeguard the funds.

What We Found

The County did not always follow applicable regulations and its submission to HUD while disbursing CDBG funds. Specifically, (1) CDBG funds were disbursed for ineligible and defaulted float loans, (2) the County and its subgrantees did not always comply with procurement requirements, (3) grant agreements did not contain the required provisions to ensure compliance with HUD requirements, and (4) substantial changes to program activities were not amended appropriately.

Consequently, more than $1.2 million was disbursed for ineligible or defaulted float loans, $517,125 was spent without adequate procurement processes, inadequate agreements with its subgrantees could hinder the County's efforts to monitor and enforce CDBG requirements, and neither HUD nor the citizens of Essex County were provided current and accurate information on the County's CDBG program activities.

In addition, there were control weaknesses in the County's financial management system used to safeguard funds. Specifically, the County's financial management system did not ensure that CDBG funds were disbursed in a timely manner and properly safeguarded.

What We Recommend

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the County to (1) reimburse to the CDBG program from nonfederal funds more than $1.2 million for ineligible and defaulted float loans; (2) provide supporting documentation for the two procurements totaling $517,125; (3) reimburse more than $2.6 million in excess checking account funds to the CDBG program if the County does not immediately disburse the funds; (4) remit $280,108 in bank interest; (5) reimburse to the CDBG program $179,091 for the unnecessary drawdowns of funds; and (6) establish procedures to ensure that CDBG funds will be disbursed in a timely manner and in accordance with program requirements.

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 a draft report to County officials on April 15, 2008 and requested their responses by May 6, 2008. We discussed the results of our review during the audit and at an exit conference on May 6, 2008. County officials provided their written comments on May 6, 2008. They generally concurred with the draft report findings. 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

The Community Development Block Grant (CDBG) program was established by Title I of the Housing and Community Development Act of 1974 (Public Law 93-383). The program provides grants to state and local governments to aid in the development of viable urban communities. Governments are to use grant funds to provide decent housing and suitable living environments and to expand economic opportunities, principally for persons of low and moderate income. To be eligible for funding, every CDBG-funded activity must meet one of the program's three national objectives. Specifically, every activity, except for program administration and planning, must

- Benefit low-and moderate-income persons,
- Aid in preventing or eliminating slums or blight, or
- Address a need with a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

The County of Essex (County) is a CDBG entitlement recipient that has administered approximately $7 million in CDBG funds annually during the past 10 years. Theses funds are available to support a variety of activities directed at improving the physical condition of neighborhoods by providing housing or public improvements/facilities, fostering economic development by providing technical and financial assistance to local businesses, creating employment, or improving services for low- and/or moderate-income households.

The County is a diverse consortium of urban and suburban communities. Eighteen municipalities participate in the County's CDBG program. Several nonprofit organizations also receive CDBG funds from the County to help carry out activities. The Division of Housing and Community Development (Division) is designated by the county executive to administer the County's CDBG funds programmatically and financially, including overseeing and monitoring subgrantees as well as directly delivering CDBG-funded activities. In addition, the Office of Accounts and Control and the Treasury Office are responsible for handling financial transactions and the accounting records of the County's CDBG program upon authorization from the Division. The files and records related to the County's CDBG programs are maintained at 20 Crestmont Road, Verona, New Jersey, and 465 Dr. Martin Luther King, Jr., Boulevard, Newark, New Jersey.

We audited the County's CDBG program because of the size of its program, a high risk score based on the U.S. Department of Housing and Urban Development's (HUD) 2006 annual risk assessment, and indicators of unreported program income. Our audit objectives were to determine whether the County (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to HUD and with applicable rules and regulations and (2) had a financial management system in place to adequately safeguard the funds.

RESULTS OF AUDIT

Finding 1: The County Did Not Always Comply with HUD Regulations While Disbursing CDBG Funds

The County did not always comply with applicable regulations and its submission to HUD while disbursing CDBG funds. Specifically, (1) CDBG funds were disbursed for ineligible and defaulted float loans, (2) the County and its subgrantees did not always comply with procurement requirements, (3) grant agreements did not contain the required provisions to ensure compliance with HUD requirements, and (4) substantial changes to program activities were not amended appropriately. This noncompliance occurred because the County did not develop and implement adequate program and financial controls over its CDBG activities. As a result, more than $1.2 million was disbursed for ineligible or defaulted float loans, $517,125 was spent without adequate procurement processes, inadequate grant agreements with its subgrantees could hinder the County's efforts to monitor and enforce CDBG requirements, and neither HUD nor the citizens of Essex County were provided current and accurate information on the County's CDBG program activities.

Ineligible and Defaulted Float Loans

Regulations at 24 CFR (*Code of Federal Regulations*) 570.301(b) permit a grantee to use CDBG funds that are budgeted for activities that will not immediately use the funds to finance additional activities that would otherwise not receive CDBG assistance through the grantee's regular budget process. Such funds are referred to as "float," and the float-funded activities are expected to produce program income to repay the amount of the float funds used. Under this guideline, the County established the Community Development Float Loan Program to provide short-term zero- and low-interest loans for commercial revitalization, housing projects, and economic development. However, the County did not fully comply with the regulations.

The County had disbursed $731,111 for five ineligible float loans to various County municipalities since 2002. Regulations at 24 CFR 570.301(b)(2) and (3) specify that float loans should be repaid from program income within 2.5 years, and the grantee must include in its action plan the float-assisted activities as well as the full amount of expected program income from these activities. However, the loan agreements indicated that the County improperly committed future CDBG grant funds that were not guaranteed by HUD or awarded to these municipalities as the source of repayments instead of mandating the municipalities to generate and use program income from these activities for repayment. In addition, the annual action plan submitted to HUD by the County did not properly provide information on the float-assisted activities and the associated program income. This deficiency occurred because the prior director of the Division of Housing and Community Development (Division) incorrectly interpreted the regulations, and County staff carried out the float loan program under the wrong guidance. As a result, funds were expended for loans that did not meet requirements and, therefore, imposed an increased risk of loss to the HUD CDBG program.

Further, two float loans provided to local businesses before 2002 had defaulted with unrecovered principal balances of $500,111. The County did not follow 24 CFR 570.301(b) (4) in committing to undertake a proper remedy when the float loans defaulted. Instead, it used its CDBG contingency funds, which were part of its budget for general administrative costs, to cover the funding shortfalls caused by the defaults. It also redistributed CDBG fund allocations from other projects to replenish those projects for which original funding was used to finance the float loans. In addition, the Division cancelled certain projects or reduced their funding without adequately involving citizens and notifying HUD about the amendments to these activities. As a result, HUD lost $500,111 for the two defaulted loans, and several other projects were negatively impacted because of funding shortages that resulted from the defaults. We attribute this deficiency to inadequate program controls over float loans.

Inadequate Procurement Processes

The County did not ensure that its subgrantees always followed the procurement policies and procedures of 24 CFR 85.36 and the relevant laws of the state of New Jersey. For example,

The Township of Belleville, a subgrantee of the County, purchased a fire truck for $277,125. The Township of Maplewood, another subgrantee of the County, awarded a contract for $240,000 to a construction company for the Springfield Avenue Improvement project. However, both Townships failed to re-advertise the bid and improperly awarded the contract to the vendor that was the single bidder on the first occasion. Thus, it violated section 40A:11-5(3) of New Jersey Local Public Contracts Law, which requires that the local government advertise the bids on two occasions.

These instances indicated that the County did not have adequate controls over procurements by its subgrantees. Accordingly, it did not ensure that quality goods and services were obtained at the most advantageous terms for CDBG activities.

Inadequate Grant Agreements

The grant agreements between the County and its CDBG subgrantees did not contain the provisions required by 24 CFR 570.503. Specifically, the agreements did not contain sections regarding the statement of work, records and reports, program income, uniform administrative requirements, other program requirements, suspension and termination, and reversion of assets. As a result, the County might be subject to an unnecessary risk as it could be difficult to monitor and enforce HUD requirements without properly executed grant agreements. We attribute these conditions to the lack of controls to ensure compliance with program requirements. County officials informed us that they were taking immediate steps to redesign the grant agreements.

Inadequate Program Amendment Policy

The County did not adequately amend its CDBG program plan when activities were significantly changed. Regulations at 24 CFR 91.505 state that grantees shall request prior HUD approval for all program amendments involving new activities or alteration of existing activities that will significantly change the scope, location, or objectives of the approved activities or beneficiaries. In addition, 24 CFR 91.105 and 505 state that the grantee must identify in its citizen participation plan the criteria it will use for determining what constitutes a substantial amendment, and any substantial amendments must be subject to a citizen participation process.

Contrary to the regulations, the County did not develop the proper citizen participation plan and, therefore, did not make any amendment public or notify HUD when it significantly changed its action plan and reprogrammed already allotted CDBG funds to fund different activities. For instance,

- The County originally awarded $125,000 to its Office of Culture Diversity on December 4, 2003, for the Culture Disparity Study project. However, this activity was not included in the County's action plan for program year 2003, and no amendments were submitted to HUD, nor were the citizens informed. In addition, the consolidated annual performance and evaluation report for program year 2005 showed that the total disbursement for this project was $300,000. Although the additional funding of $175,000 was approved by the County freeholders, no addendum was added to the original grant agreement. Thus, HUD and the citizens of the County were not aware of this change.

- The County awarded and disbursed more than $1 million for the Countywide Road Surfacing project during 2005 and 2006. However, the activity was not included in the action plans, and no amendment was submitted to HUD or made public. In addition, the County only recorded $236,517 in HUD's Integrated Disbursement and Information System. The remaining $830,000 was not set up in HUD's system and was disbursed directly from the County's general CDBG bank account without a proper budgeting and recording process. Due to the high balance in the County's general CDBG account (see finding 2), the County was not aware of this issue until we identified it.

- The County canceled or changed the funding amounts for several HUD-approved projects without adequately notifying HUD or the citizens. For example, the Township of Belleville canceled the purchase of an ambulance and used the $93,750 to procure a fire truck.

We attribute this deficiency to the County's weak management controls over compliance with HUD regulations. As a result, the County could not ensure that it administered its CDBG activities as planned and determine whether activities were accurately reported to HUD. Further, the citizens of the County were not provided an opportunity to comment on substantial changes to the CDBG program.

Conclusions

The County did not always comply with applicable regulations and its submission to HUD while disbursing CDBG funds. Consequently, more than $1.2 million was disbursed for ineligible float loans, $517,125 in procurement-related disbursements was not adequately supported, inadequate grant agreements between the County and its subgrantees could hinder the County's efforts to monitor and enforce CDBG requirements, and neither HUD nor the citizens of the County were provided current and accurate information on the County's CDBG program. We attribute these deficiencies to the lack of adequate program and financial controls over CDBG activities.

Recommendations

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the County to

1A. Develop and implement adequate procedures pursuant to 24 CFR 570.301 before issuing new float loans.

1B. Reimburse the CDBG program from nonfederal funds the $1,231,222 related to ineligible float loan disbursements ($731,111 for ineligible commitments for five float loans and $500,111 in unrecovered principals related to the two defaulted float loans).

1C. Provide supporting documentation for the $517,125 related to the purchase of the Township of Belleville fire truck ($277,125) and the Maplewood Springfield Avenue Improvement project ($240,000) so that HUD can determine whether proper procurement procedures were followed. Any purchase that did not comply with procurement standards at 24 CFR Part 85.36 should be considered ineligible and must be reimbursed from non-federal funds to CDBG funds.

1D. Amend its grant agreements to include all applicable sections in accordance with 24 CFR 570.503

1E. Develop and implement procedures to properly amend program activities, including providing a citizen participation plan, and incorporate them in the County’s action plan in accordance with HUD regulations.

Finding 2: There Were Control Weaknesses in the County's Financial Management System

Weaknesses in the County's financial management system caused it to not always comply with HUD requirements. Specifically, the County (1) inappropriately maintained a high cash balance and did not disburse funds in a timely manner, (2) did not properly record and report program income from its Home Improvement Program, (3) did not remit bank interest income to the U.S. Treasury, (4) made unnecessary drawdowns of CDBG funds, (5) made improper transfers between the HOME and CDBG programs, and (6) did not establish adequate communication among County offices when making financial transactions. As a result, approximately $3 million in CDBG funds was not used in a timely manner, $720,060 in program income was not properly recorded and reported to HUD, $280,108 in interest income was not remitted to the U.S. Treasury, $179,091 was unnecessarily drawn down from HUD, and CDBG funds may not have been properly safeguarded due to improper funds transfers between programs and miscommunication among the County offices.

High Cash Balance and Untimely Disbursement of Funds

The County inappropriately maintained an excessive cash balance with an average of $3 million in its general CDBG checking account for several years. Regulations at 24 CFR 85.20(b)(7) state that the grantee must make drawdowns as close as possible to the time of making disbursements. However, as of the end of program year 2006, the general CDBG checking account had a balance of more than $2.9 million. The County also maintained another general CDBG bank account with a different bank, and this account had a $140,572 ($140,351 principle plus $221 accumulated interest) cash balance that had not been used for any CDBG activities since July 2006.

It appeared that one of the reasons for the high cash balance was that the County drew down funds several months before making payments to the vendors. For instance, $181,850 was drawn down on March 29, 2005, for the Lafayette Park Renovation project; however, the payments were not made to the vendor until December 2005. In addition, for the purchase of a fire truck at the Township of Belleville, $170,000 was drawn down on March 28, 2006, three weeks before the public bidding date, but was not paid out until June 30, 2006. These pre-drawdowns were made so that the County could meet its timeliness requirement since HUD conducts timeliness tests at the beginning of April.

The County should have disbursed all drawdowns of CDBG funds and should not have maintained such high cash balances; therefore, these funds should either be used before any additional drawdowns from HUD or returned to the CDBG program. Accordingly, approximately $3 million[1] or the current balance of the two CDBG bank accounts should be returned to the CDBG program if the County cannot make immediate disbursements for eligible CDBG activities.

Further, the County did not comply with HUD's timeliness requirements for the disbursing of funds. Regulations at 24 CFR 570.902 state that, before the funding of the next annual grant and absent contrary evidence satisfactory to HUD, HUD will consider an entitlement recipient to be failing to carry out its CDBG activities in a timely manner if 60 days before the end of the grantee's program year, the sum of the balance of its line-of-credit (the amount of entitlement grant funds available to the recipient under grant agreements but undisbursed by the U.S. Treasury) and the program income on hand exceeds 1.5 times of the annual entitlement grant. If the County's excess cash balance of approximately $3 million were added back to the balance of its CDBG line-of-credit, its available funds would exceed 1.5 times the amount of the annual grant. As a result, the County did not obligate and disburse its available program funds in a timely manner.

Unreported Program Income

The County did not adequately record or report the receipts and expenditures of program income as required by 24 CFR 570.504. Section 570.500(a)(1)(v) further states that payments of principal and interest on loans made using CDBG funds are considered to be program income. The County's Home Improvement Program (HIP) provides loans to the residents for the repairs of their primary homes. The bank statements showed that the County received HIP loan repayment amounts of $349,266 and $370,795 during program years 2005 and 2006, respectively. However, the receipts and associated disbursements of the program income of these two years were not recorded in HUD's Integrated Disbursement and Information System or accurately reported in the consolidated annual performance reports. The reports showed program income of $25,808 and $255,412 for program years 2005 and 2006. This noncompliance was due to the lack of communication among the program staff and inadequate management controls. As a result, there was no assurance that the County reported accurate CDBG financial information to HUD in accordance with HUD regulations. Further, HUD could not determine the amount of income that had been generated from the loan repayments or how this income had been used.

Unremitted Bank Interest

The County did not adequately remit bank interest earned from its CDBG interest-bearing accounts. Regulations at 24 CFR 570.500(a)(2) prescribe that the interest earned on grant advances must be remitted to HUD for transmittal to the U.S. Treasury. The total amount of bank interest earned from the County's two general CDBG bank accounts during

[1] The $3 million includes $260,952 in unremitted bank interests earned from the two CDBG bank accounts and $179,091 in unnecessary drawdowns. Since we make separate recommendations (see 2D and 2E) for these two issues, the total reimbursement amount would be $2,614,434 for recommendation 2B.

program years 2004 through 2006 was $260,952. In addition, the County earned $19,156 in interest from one of its repayable loan programs during these three program years. Therefore, the total amount of interest income of $280,108 ($260,952 + $19,156) should be remitted to HUD for transmittal to the U.S. Treasury. We attribute this deficiency to inadequate financial controls.

Unnecessary Drawdowns

Although the program income of $179,091 was used to pay the expenses of several projects according to 24 CFR 570.504(b)(2)(ii), the County unnecessarily drew down $179,091 from its entitlement grant for the same project expenses in program year 2005. This problem was due to the lack of communication among the program staff and inadequate management controls. Therefore, this duplicate amount drawn down from HUD-is ineligible and should be repaid to its CDBG line-of-credit.

Improper Fund Transfers between CDBG and HOME Programs

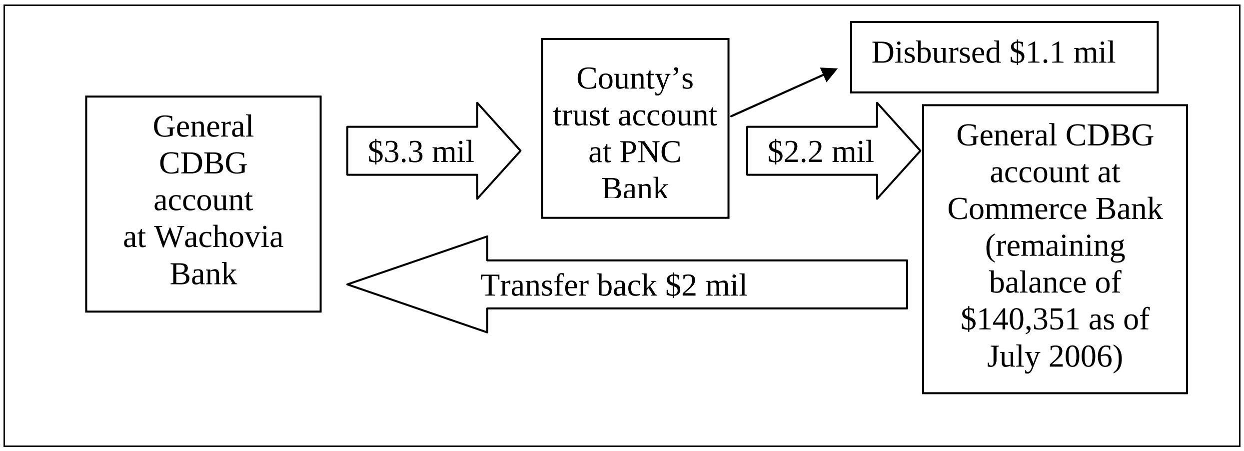
The County improperly transferred funds between the CDBG and HOME programs. This conduct may violate regulations at 24 CFR 570.200, which require that an activity may be assisted with CDBG funds only if it meets one of the CDBG national objectives. The County explained that these fund transfers were to borrow funds from HOME to make payments for CDBG activities while CDBG funds were not available and vice versa and because top management of the County thought that federal funds could be transferred between federal programs. As a result, CDBG funds were not properly safeguarded.

Inadequate Communications among the County Offices

The County's Division of Housing and Community Development (the Division) relied on the Office of Accounts and Controls for financial transactions including issuing payment checks to vendors and subgrantees, maintaining accounting records of the cash receipts and disbursements, managing bank accounts, etc. In addition, all of the cashed checks were maintained and reconciled with the bank statements by the Treasury Office. Therefore, any inadequate communication among these three offices could jeopardize CDBG funds.

For example, without notifying to the Division, the Office of Accounts and Controls transferred $3.3 million from the general CDBG checking account at Wachovia Bank to the County's trust account at PNC Bank in June 2006 when the County had a dispute with Wachovia Bank. Later, approximately $1.1 million was disbursed from the PNC account for CDBG activities, and $2.2 million was transferred to a new CDBG account at

Commerce Bank. In July 2006, when the dispute was resolved, the Office of Accounts and Controls transferred $2 million back to the CDBG account at Wachovia and left a balance of $140,351 at Commerce Bank. Although the County's Treasury Office and the Office of Accounts and Control knew about these transactions, the Division was not informed of the transactions and was not fully aware of the new account at Commerce Bank until we noted the issue.



In addition, the County did not reconcile HUD's Integrated Disbursement and Information System drawdowns with its accounting records of expenditures. The Division only reconciled its drawdowns with deposits into the general CDBG account at Wachovia Bank. The Office of Accounts and Control and the Treasury Office only reconciled their accounting records of CDBG expenses with the withdrawals from the bank account. However, there is no reconciliation of CDBG cash transactions among the Office of Accounts and Control, the Treasury Office, and the Division. As a result, accurate financial information may not have been reported to HUD, and excessive cash balances and unneeded drawdowns may have resulted as noted in this finding.

Accordingly, the lack of communication among the County offices jeopardized the proper administration of the CDBG funds by the Division.

Conclusions

The County had control weaknesses in its financial management system that caused it to (1) inappropriately maintain a high cash balance and not disburse CDBG funds in a timely manner, (2) not accurately record and report the program income from its Home Improvement Program, (3) not remit bank interest income to the U.S. Treasury, (4) make unnecessary or unsupported drawdowns and disbursements, (5) make improper transfers of funds between the HOME and CDBG programs, and (6) not ensure adequate communication between the County offices to properly safeguard cash. We attribute these deficiencies to the control weaknesses in its financial management system.

Recommendations

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the County to

2A. Develop and implement procedures to ensure that CDBG funds are drawn down as expenses are incurred and disbursed in a timely manner.

2B. Immediately disburse the excess checking account balance of $2,614,434 or the current balance on hand for eligible CDBG activities or return these funds to the County's CDBG line-of-credit if the County cannot use the funds immediately in accordance to federal regulations.

2C. Develop and implement a control plan to ensure that $720,060 for program years 2005 and 2006 and any future program income will be properly recorded, reported, and disbursed in accordance with program regulations.

2D. Remit $280,108 in bank interest generated in program years 2004 to 2006 to the U.S. Treasury so that these funds can be put to better use.

2E. Reimburse the CDBG program $179,091 related to the unnecessary drawdowns for expenses already paid with program income.

2F. Develop and implement procedures to ensure that CDBG funds are safeguarded and that interfund transfers of CDBG funds are prohibited.

2G. Develop and implement procedures to ensure that all financial transactions of the CDBG program are properly authorized and communicated to the Division; and that all accounting records are properly reconciled between the county's Office of Accounts and Control, Treasury Office, and the Division of Housing and Community Development.

SCOPE AND METHODOLOGY

The audit focused on determining whether the County complied with HUD regulations, procedures, and instructions related to the administration of the CDBG program. To accomplish our objectives, we

- Reviewed relevant federal and New Jersey state regulations.
- Interviewed appropriate personnel of HUD's Office of Community Planning and Development Newark field office and reviewed relevant grant files to obtain an understanding of CDBG program requirements and identify HUD's concerns with the County's operations.
- Reviewed the County's policies, procedures, and practices and interviewed key personnel to obtain an understanding of the County's administration of the CDBG program.
- Reviewed monitoring and independent accountant audit reports.
- Reviewed and tested the County's files and records of selected projects to test whether (a) costs were eligible and adequately supported as required by HUD regulations and (b) the County carried out these projects in accordance with HUD requirements and its submission to HUD.

The County's consolidated annual performance and evaluation report reflects that more than $8.37 million in CDBG funds was disbursed for 364 activities between June 1, 2005, and May 31, 2006 (program year 2005). We grouped these activities into five categories: administration, economic development, public services, the Home Improvement Program (HIP), and other public facilities and improvements (non-HIP). We selected the activities with the highest disbursement amounts from each category, resulting in a sample of 20[2] activities totaling approximately $3.39 million. We reviewed the disbursements and related supporting documents for the sampled activities to determine whether the expenditures were reasonable and complied with CDBG requirements and federal regulations. We also examined all of the 14 float loans that the County had issued during the past 10 years totaling more than $5.5 million. In addition, we evaluated whether program income was recorded during our audit period and tested the County's internal controls over its administration of the CDBG program.

The audit generally covered the period from June 1, 2005, through May 31, 2006, and was extended when necessary to accomplish our objectives.

[2] One activity was for administrative costs of $180,000 incurred by the Economic Development Corporation (EDC), a subgrantee of the County. We will issue a separate report for the CDBG activities administered by EDC.

We performed our audit fieldwork from August 2007 through February 2008 at the County's offices in Verona and Newark, New Jersey. We conducted 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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

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

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:

- The County did not have adequate controls over compliance with laws and regulations, as it did not always comply with HUD regulations while disbursing CDBG funds and reporting its financial data to HUD (see findings 1 and 2).

- The County did not adequately safeguard resources when it (1) inappropriately maintained a high cash balance and did not disburse funds in a timely manner, (2) did not properly record and report program income from its Home Improvement Program, (3) did not remit bank interest income to the U.S. Treasury, (4) made unnecessary drawdowns of CDBG funds, (5) made improper transfers between the HOME and CDBG programs, and (6) did not establish adequate communication among County offices when making financial transactions (see finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1B	$1,231,222		
1C		$517,125	
2B			$2,614,434
2C			$720,060
2D			$280,108
2E	$179,091		
Total	$1,410,313	$517,125	$3,614,602

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 polices 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.

3/ 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. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures, and any other savings which are specifically identified. In this instance, if the County disburses the excess checking account balance of more than $2.6 million immediately or repays these funds to HUD; develops a plan to ensure that $720,060 and any future CDBG program income is properly recorded, reported, and disbursed; and remits $280,108 of bank interest income; HUD can be assured that these funds (more than $3.6 million) will be put to better use, as it will eliminate unnecessary drawdowns of funds, result in the recapture of interest income, help ensure that funds are used in a timely manner for eligible activities and enable HUD to determine when funds have not been disbursed timely so that appropriate corrective action can be taken.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

DEPARTMENT OF ECONOMIC DEVELOPMENT, TRAINING AND EMPLOYMENT
DIVISION OF HOUSING & COMMUNITY DEVELOPMENT

20 Crestmont Road, Verona, N.J. 07044
Tel: (973) 655-0200
Fax: (973) 655-0982

Joseph N. DiVincenzo, Jr.
Essex County Executive

Anibal Ramos, Jr.
Department Director

E. Michael Taylor
Division Director

May 5, 2008

Mr. Joseph Vizer
U.S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278

Dear Mr.Vizer:

In response to the draft audit report received on April 17, 2008, the Essex County Division of Housing & Community Development would like to formally address the issues documented in this correspondence as outlined below:

Summary
The draft audit report contains two findings:
Finding 1: The County did not always comply with HUD regulations while disbursing CDBG funds.
Finding 2: There were control weaknesses in the County's financial management system.

Finding 1
Funds for Float Loans
Regulations at 24 CFR 570.301(b)(2) and (3) specify that float loans should be repaid from program income within 2.5 years, and the grantee must include in its action plan the float-assisted activities as well as the full amount of expected program income from these activities.

Putting Essex County First

ESSEX COUNTY IS AN EQUAL OPPORTUNITY EMPLOYER

County Response: The County entered into 5 float loans with municipalities within the consortium from 2002-2006. The loans are listed in the chart below:

Recipient		Amount	Date	Repayment
West Orange Boys & Girls Club		$300,000	4/18/02	$300,000
Fairfield Broadway Lane Sanitary Sewer		$258,961	12/5/03	$258,961
Nutley Sr. Citizen Day Center		$ 90,000	10/15/03	$ 90,000
Nutley Radcliff School ADA elevator		$ 40,000	5/13/04	$ 40,000
Orange Montclair Child Development roof		$ 42,150	1/17/07	$ 42,150
	Total	$731,111		$731,111

In addition, the County entered into 3 float loans with private businesses as listed below:

Recipient		Amount	Date	Repayment
FEB Realty, LLC		$490,000	2/10/00	$120,852.68
Ottimo Corp./Pronto Cena		$500,000	9/12/00	$369,036.46
Toma Parrow St.		$150,000	3/12/01	$ 57,097.76
	Total	$1,140,000		$546,986.90

LOANS WITHIN THE CONSORTIUM

The five loans issued within the consortium were disbursed and subsequently repaid with the municipalities CDBG allocations. The County listed these repayments in its Public Notices and its submitted Action Plans. All projects met a national objective and enabled the County to realize important improvements to its facilities. Upon inspection of the auditors' review, the County agrees with the auditors' comment that the prior administration incorrectly interpreted the regulations, which eventually led to staff implementing the float loan program under the wrong guidance.

Comment 1

Corrective Action: The County has ceased the issuance of all float loans. The loans to the municipalities were all paid back albeit with CDBG dollars. The County recognizes that there was a misinterpretation; however, there were no adverse affects from the issuance of these loans. Since the loans were fully repaid, the County does not agree that a repayment is necessary. The County will not enter into float loan agreements with participating municipalities unless and until the proper policies and procedures are developed and approved by HUD.

LOANS TO LOCAL BUSINESSES

The County has reviewed the float loans to local businesses and found that the un-recovered principal balance to be $593,013. The County had utilized all legal methods at its disposal to recapture the funds from the borrowers. For example, the loan to FEB Realty, LLC involved a filing for Chapter 11 bankruptcy by the borrower FEB Realty, LLC (Attachment A). In addition, the personal guarantor, Fadi J. Bejjani, MD filed for Chapter 7 bankruptcy protection (Attachment B). The County held a second mortgage on the property located at 1624 Springfield Avenue, Maplewood, NJ. The Bank of New York held a first mortgage on the property in the amount of $392,028. The County negotiated with the Chapter 7 Trustee to accept a "carve out" of $120,852.68 from the proceeds of the sale of the property (Attachment C) as opposed to receiving nothing through a foreclosure proceeding.

In addition, the loan to Ottimo Corp. involved a foreclosure on the property used to secure the loan. The County held a third mortgage on the property in the amount of $150,000 (Attachment D). The property was sold in a sheriff's sale leaving the County with net proceeds of $19,036.46.

Lastly, the loan to Toma Parrow Street involved a loan of $150,000 to Toma Group, Inc. for the construction of six two family homes. The Toma Group, Inc. repaid the County $50,000 for the two housing units they completed along with interest of $7,097.76. On August 13, 2001 the County was notified of a Chapter 7 bankruptcy filing by the borrower (Attachment E). The property and unfinished construction of the four two family homes was sold by Toma Group, Inc. to BJM Construction, Inc. BJM Construction, Inc. assumed all of the obligations of Toma under the Loan Agreement, Note and Mortgage on June 25, 2003 (Attachment F). As of today, the County is due $50,000 plus interest on two additional units, which have been completed but have yet to be sold, due to the slow real estate market. The two remaining properties have not been developed to date. In addition to the HUD money invested in this project, there is $405,000 in NJ DCA funds invested in this project as well as $120,000 in RCA funds.

Comment 2

Corrective Action: These loans were approved under a prior administration. The practice has been discontinued. The County will not enter into float loan agreements with private sector or not for profit entities unless and until the proper policies and procedures are developed and approved by HUD.
With regard to the outstanding balance of the BJM Construction Inc. (assumed from Toma Group Inc.) loan, the builder has recently completed two additional multifamily homes and we expect a payment of $50,000 plus any interest due by the end of May. We have been advised that the final phase of two additional multifamily homes will be completed by December of 2008. Since these projects meet the objectives of providing affordable housing, we are requesting that they be completed. We are also requesting that the interest already paid and the anticipated collection funds plus interest be credited to the amount due HUD for the defaulted loans (Attachment G).

Inadequate Procurement Practices

The County did not ensure that its subgrantees always followed the procurement policies and procedures of 24 CFR 85.36 and the relevant laws of the state of New Jersey.

Comment 3

County Response: The Township of Belleville purchased a fire truck for $277,125. The recipient advertised for bidders in the Star-Ledger on April 3, 2006 and on April 20, 2006 awarded the contract to the sole bidder (Attachment H). The auditor cites NJSA 40A:11-4.5 (Attachment I), the competitive contracting provision of "Local Public Contracts Law" for the 20 day advertising period. Competitive contracting may only be used for limited purposes as cited in NJSA 40A:11-4.1 (Attachment J). The purchase of a fire truck is not allowable under the provisions of competitive contracting. The Township correctly referred to Section 40A:11-23 of the NJ Public Bidding Law to justify their action. The citation states that an award can be made 10 days after an advertisement appears in a published newspaper. Furthermore, the auditor cited the provisions (NJSA40A:11-5(3) (Attachment K) for negotiating after a bid has been rejected twice. In this instance, a sole responsible bidder was accepted by the Township in accordance with the law. A sole bidder is not a valid reason to reject a bid unless it does not meet the criteria of the law.

No Corrective Action Necessary

The Township of Maplewood received $240,000 for the Springfield Ave Improvement Project. The recipient advertised for bidders in the Maplewood/South Orange News-Record on August 4, 2005 and on August 30, 2005 received one sealed bid package (Attachment L). The auditor cites NJSA 40A:11-4.5, the competitive contracting provision of "Local Public Contracts Law" for the 20 day advertising period. Competitive contracting may only be used for limited purposes as cited in NJSA 40A:11-4.1. The construction projects generally are not allowable under the provisions of competitive contracting. The Township correctly referred to Section 40A:11-23 (Attachment M) of the NJ Public Bidding Law to justify their action. The citation states that an award can be made 10 days after an advertisement appears in a published newspaper. Furthermore, the auditor cited the provisions (NJSA40A:11-5(3) for negotiating after a bid has been rejected twice. In this instance, a sole responsible bidder was accepted by the Township in accordance with the law. A sole bidder is not a valid reason to reject a bid unless it does not meet the criteria of the law.

No corrective action necessary

Inadequate Grant Agreements

The grant agreements between the County and its CDBG subgrantees did not contain the provisions required by 24 CFR 570.503. Specifically, the agreements did not contain sections regarding the statement of work, records and reports, program income, uniform administrative requirements, suspension and termination, and reversion of assets.

Comment 4

County Response: The County believes its grant agreements do address the specific sections regarding the statement of work, records and reports, program income, uniform administrative requirements, suspension and termination, and reversion of assets found in 24 CFR 570.503 (Attachment N). The County generally refers to and includes the proposal as part of the award and execution of any contract for goods or services. It was noted however, that grantees had not signed their Scope of Services and they were not attached to the contract.

Corrective Action: The County immediately addressed this issue during its 2007 Program Year contracts. The County has already incorporated this change to its grant agreements and will continue to do so in the future.

The County has also asked for a technical assistance meeting with HUD CPD. Upon guidance from HUD CPD the County will incorporate any additional language and or attachments necessary into its contract documents.

Inadequate Program Amendment Policy

The County did not adequately amend its CDBG program plan when activities were significantly changed. Regulations at 24 CFR 91.505 and 570.427 state that grantees shall request prior HUD approval for all program amendments involving new activities or alteration of existing activities that will significantly change the scope, location, or objectives of the approved activities or beneficiaries. In addition, the grantee must make the amendment public in accordance with citizen participation requirements in section 570.431. Further, 24 CFR 91.105 and 505 state that the grantee must identify in its Citizen Participation Plan the criteria it will use for determining what constitutes a substantial amendment, and any substantial amendments must be subject to a citizen participation process.

Contrary to the regulations, the County did not develop the proper Citizen Participation Plan and therefore, did not make any amendment public or notify HUD when it significantly changed its action plan and reprogrammed already allotted CDBG funds to fund different activities.

Comment 5

Corrective Action: The division has already begun to develop a program amendment policy and procedure. In evidence of this, the division advertised the recapture and reprogramming of over $600,000 in January, 08. This represents the first time a change process that involves public notice and comment has been undertaken by this division. We have also informed consortium members that there will be new policies forthcoming to comply with HUD regulations and they will be strictly enforced. To develop these policies and procedures, we have requested technical assistance from the HUD Newark office to determine what is required to meet HUD's standards in this area. The policies will be implemented as soon as possible thereafter.

Finding 2

Control Weaknesses
The County inappropriately maintained excessive cash balances due to pre-draws to meet timeliness issues. Disbursements were not made timely in accordance with HUD regulations.

County Response: Upon review of our accounts we agree the balances were high. Among other things we have discovered questionable deposits and transfers. Some of this was due to a practice by the division under prior administrations to reduce the number of old accounts by combining balances and rolling them forward. These rollovers were not reconciled to actual reporting in IDIS or previous systems. Upon review it was determined that the concept of rolling balances forward from one program year to the next was creating confusion for our staff. Additional funds were drawn down in order to meet federal timeliness requirements but not actually disbursed.

Comment 5

Corrective Action: Where possible, the County will make corrections to the transactions that took place. We believe that the majority of the funds are simply the result of practices that are no longer in place. To spend down these balances the County proposes the attached spending plan (Attachment O) for eligible projects and a time line for their completion. The alternative is to refund the cash balances to HUD.

Timeliness
The County has drawn federal funds and not disbursed them in a timely manner.

County Response: Timeliness has been a long-standing problem for the division. Over the past 3 years the division has made great progress with timeliness. One contributing factor is that our program year begins June 1st of each year. But the Notice of Award (NOA) is not received until the fall. Both the County and our member municipalities must be able to certify funds in order to award contracts. We cannot certify funds to our consortium members nor can they certify funds for the award of contracts until the actual funding is awarded to the County. As a result, the summer construction window is lost and by the time the funds are available, the weather window has closed and many municipalities can't start until the weather breaks in the spring – which is when timeliness is measured.

Comment 5

Corrective Action: The County along with our consortium members will explore the possibilities and the requirements necessary to begin the bid and award process prior to federal NOA. We will also discuss with the local office of HUD the possibilities and steps necessary to expedite the NOA process.

Unreported Program Income
The County did not adequately record or report expenditures of program income.

Comment 5

County Response: The County has receipted $729,546.48 in program income for the HIP program for program years '05 & '06 into IDIS (Attachment P). The County is in the process of uploading completion data for the HIP program in regards to this program income.

No Corrective Action Required

Bank Interest
The County did not remit bank interest in accordance with federal regulations.

Comment 5

Corrective Action: All interest earned during the period of examination is being returned to HUD. The attached review of our accounts shows $280,107.37 interest earned during the audit period (Attachment Q). (There is a slight difference with the estimate provided by the auditor). The County is in the process of remitting interest to

Comment 5

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Comment 5

Comment 1

Comment 1

Comment 3

Comment 4

Comment 5

HUD at the conclusion of the audit process. Thereafter, the County will remit annually any interest earned to HUD in accordance with federal regulations.

Unnecessary Draw Downs
The County attributed program income funds to expenses in program funds.

Corrective Action: The County will make the corrections to IDIS to charge program income and create the corresponding credit to the 2005 program account.

Improper transfers
The County improperly transferred funds between bank accounts.

Corrective Action: The division no longer transfers funds between accounts.

Communications
The Office of Accounts and Control made transfers without notification to the Division.

County Response: Under Local Public Finance Law 40A:5-14 (Attachment R), the Governing Body designates the authorized depositories for the County. The County Treasurer and the Office of Accounts and Control are charged with the responsibility of maintaining and reconciling all bank accounts and the cash management plan. The Division of Housing and Community Development has improved communications between all entities involved with managing our funds. We now have a liaison with Accounts and Control. We have initiated internal structural and staffing changes to improve communication and coordination between all financial staff.

Corrective Action: The division now reconciles its records with the County books and records. Those records can now be reconciled with IDIS. We will also undertake a similar system that will reconcile all cash draws to the actual draw downs and disbursements in the County bank accounts on a monthly basis.

Response to Recommendations:

1A. The County has stopped issuance of all float loans. The County will not issue new float loans until revised policies and procedures are developed and approved by HUD.

1B. The float loans to participating municipalities ($731,111) have been repaid.

We are requesting that the float loan balance for loans to private balances be adjusted for interest received and that one outstanding loan (Toma Parrow St.) allowed to the completion of the project. The principal and interest from the completed project along with the remaining balance of the defaulted loans is to be remitted to HUD.

1C. Documentation that both municipalities acted properly under Local Public Contract Law (NJSA 40A:11-1 et seq) has been provided.

1D. The County will physically attach the scope of services to the actual signed contract document.

1E. The County has revised it's program amendment policy and held public hearings in January of 2008 to comply with HUD regulations. We will further review this policy with all consortium partners. We will work with the regional office of HUD to ensure that any new policy and procedure meets all federal requirements.

Comment 5

2A. As stated in the Corrective Action, the County will work with our consortium members to expedite the process to expend authorized funds. We will also pursue with HUD the steps necessary to expedite the federal approval process so that the participating municipalities can award contracts on a more timely basis.

Comment 5

2B. See Attached for the County plan and schedule for the disbursement of these funds.

Comment 5

2C. Corrections to the CDBG HIP program will be made in IDIS for program income and controls to ensure these funds are properly used in the future will be implemented.

Comment 5

2D. Funds for interest earned are in the process of being remitted to HUD.

Comment 5

2E. CDBG Program funds will be credited from program income.

Comment 5

2F. The practice of transfers and inter-funds has been discontinued.

Comment 5

2G. All transactions begin at the division level. The cash management issues cited in this audit have been addressed separately. The ability to control, reconcile and correct any transaction has been developed and is being implemented by the division.

If you have any questions, please contact me at (973) 655-0200.

Sincerely,

E. Michael Taylor
Director

OIG Evaluation of Auditee Comments

Comment 1 The County concurred with our finding that the five float loans used future CDBG allocations for repayment. However, the County insisted that no repayment was necessary because the projects funded by the five loans were CDBG eligible activities and already paid off with CDBG dollars. We disagree with the County because the float-financed projects did not generate program income as required by HUD regulations. In addition, the County failed to enforce the requirement that the loan recipients had to generate program income and use it rather than CDBG funds for loan repayments.

Comment 2 The County concurred with our finding that three float loans made to local businesses were in default with unrecovered principal balances. County officials stated that the prior administration instituted these loans and utilized all legal methods available to recapture the funds; however, the borrowers filed for bankruptcy and one property went into foreclosure sale. As such, only minimal amounts of the loan balances were recovered. Nevertheless for the third loan, officials stated that the borrower who was to build six two family homes, built several units and made repayments. Thus, officials requested that the project be completed and the funds be credited to the amounts due HUD. We acknowledged the County's efforts and their claim that these loans were approved under a prior administration; however, the County is still obligated to comply with HUD regulations, and should have had a remedy for repayment of the loans in case of default. Further, since the third defaulted float loan is now active and has begun making repayments we have adjusted the finding and reduced the total amount of the unrecovered principal balance to $500,111.

Comment 3 The County stated that the two procurement cases were required to follow the provisions of the New Jersey Public Bidding Law instead of the competitive contracting provisions of "Local Public Contracts Law" cited by the auditors. As such, we have revised the finding based on the auditee's comments and the additional supporting documents provided to us by County officials at the exit conference. However, we disagree with the County officials that its sub-grantees followed New Jersey Public Bidding Laws since contracts were awarded to vendors without advertising a second time when only one bid was received on the first occasion. Furthermore, 24 CFR 85.36 (d) (2) states that in order for sealed bids to be feasible two or more responsible bidders must be willing and able to compete effectively for the business.

Comment 4 The County does not agree with the finding, but concurred that grantees did not sign their Scope of Services and that the proposal representing sections of the contract were not attached to the agreement. As such, the County will seek technical assistance from HUD and will incorporate additional language into its contract documents.

Comment 5 The County's actions are responsive to the finding.