Issue Date May 15, 2009	
Audit Report Number 2009-NY-1010	

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

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, New York/New Jersey, 2AGA

SUBJECT: The Union County Consortium, Elizabeth, New Jersey, Had Administrative Weaknesses in Its Community Development Block Grant Program

HIGHLIGHTS

What We Audited and Why

We performed an audit of the Union County Consortium's (County) administration of its Community Development Block Grant (CDBG) program as part of the Office of Inspector General's (OIG) strategic plan goals to improve the U.S. Department of Housing and Urban Development's (HUD) fiscal accountability. We selected the County based on its administration of more than $5 million in CDBG funds annually, its low HUD Community Planning and Development 2008 risk assessment score, and because the County had not received on-site monitoring from HUD since 2004.

The objectives of the audit were to determine whether the County (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to HUD and in compliance with HUD rules and regulations, (2) maintained a financial management system to adequately safeguard funds, and (3) established adequate controls to ensure that program activities were administered properly and complied with CDBG national objectives.

What We Found

The County did not always disburse CDBG funds in accordance with regulations, maintain a financial management system that always safeguarded funds, or establish sufficient controls to ensure that program activities were properly administered and complied with CDBG national objectives. Specifically, weaknesses in the County's financial and monitoring controls caused the County to (1) draw down CDBG funds instead of first using available program income, (2) transfer program income and CDBG funds for non-CDBG uses, (3) use program income for unsupported items, (4) inadequately record and report program income, and (5) inadequately monitor its consultant. These weaknesses occurred because County officials were unfamiliar with HUD regulations and did not institute controls to adequately safeguard funds and ensure compliance with regulations.

What We Recommend

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the County to (1) establish controls to ensure that available program income is used before drawing down funds from HUD's line of credit, (2) reimburse the program income account $463,793 from nonfederal sources if the County cannot provide supporting documentation, (3) implement policies and procedures to ensure that the program income is accurately recorded and reported, and (4) instruct its consultant to remit $31,851 to the County to be put back into the County's line of credit since the funds were not disbursed.

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 discussed the results of our review during the audit and at an exit conference held on May 4, 2009. County officials were asked to provide written comments by May 6, 2009, which we received on May 5, 2009. They generally agreed with the finding and recommendations. The complete text of the County'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

Union County's (County) Division of Planning and Community Development operates under the County's Department of Parks and Community Renewal and is located at 10 Elizabethtown Plaza, Elizabeth, New Jersey. The Division of Planning and Community Development consists of four bureaus, which include the Bureaus of Community Development, Housing, Land Use, and the Administrative/Fiscal Bureau. The Bureau of Community Development is responsible for administrating the Community Development Block Grant (CDBG) program.

The CDBG program was established by Title 1 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 U.S. Department of Housing and Urban Development's (HUD) funding agreements with the County showed that the County was granted more than $5.3 million and $5.4 million in CDBG funds for program years 2006 and 2007, respectively. The County's CDBG program year runs from August 1 through July 31.

Our audit objectives were to determine whether the County (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to HUD and in compliance with HUD rules and regulations, (2) maintained a financial management system to adequately safeguard funds, and (3) established adequate controls to ensure that program activities were administered properly and complied with CDBG national objectives.

RESULTS OF AUDIT

Finding 1: The County Had Weaknesses in Its Financial and Monitoring Controls

Weaknesses existed in the County's financial and monitoring controls. Specifically, contrary to regulations, the County (1) drew down CDBG funds instead of first using available program income, (2) transferred program income and used CDBG funds for County-wide pension and other non-CDBG-related expenses, (3) used program income for unsupported items, (4) did not adequately record and report program income, and (5) did not adequately monitor its consultant to ensure compliance with escrow fund regulations. These weaknesses occurred because County officials were unfamiliar with HUD regulations and did not institute adequate controls to safeguard funds and ensure compliance with regulations. As a result, the County unnecessarily drew down over $1.2 million in CDBG funds, transferred over $1.6 million for non-CDBG uses, disbursed over $438,000 in program income for unsupported items, did not adequately record or report $1.1 million in program income , did not support a $25,000 draw down in IDIS, and did not ensure that its consultant returned over $31,000 in unused funds.

CDBG Funds Drawn Down Instead of Using Program Income

During program years 2004 through 2007, the County maintained and underutilized an average program income balance of more than $2 million since its program income receipts were inaccurately reported in the HUD's Integrated Disbursement and Information System (IDIS). For example, in February 2007, County officials drew down $171,662 of CDBG funds even though a balance of $1,922,444 in program income was available. The County's Director of Planning and Community Development stated that the former staff accountant believed that program income receipts were required to be disbursed in three working days. Therefore, the staff accountant for many years recorded program income receipts based on program costs incurred or paid, which did not reflect the actual amounts of program income receipts deposited into its bank accounts. For example on July 27, 2006, $53,000 was recorded as disbursed from program income for activity 2130 kitchen replacement and $53,000 was also simultaneously recorded as received from program income. Moreover, the inaccurate reporting of program income receipts in IDIS led to the County's inability to use its program income funds as revolving funds as defined by 24 CFR 570.500 (b) for carrying out specific activities related to its CDBG multi-jurisdictional home rehabilitation program or any other immediate cash need.

Regulations at 24 CFR 570.500 (b), defines the revolving fund as a separate fund (with a set of accounts that are independent of other program accounts) established for the purpose of carrying out specific activities which, in turn, generates payments to the fund for use in carrying out the same activities. In addition, HUD regulations at 24 CFR Part 85.21(f)(1) requires that grantees and sub-grantees shall disburse repayments to and interest earned on a revolving fund before requesting additional cash for the same activity. Regulations at 24 CFR 570.504(b) (2) (ii) requires that substantially all other program income shall be disbursed for eligible activities before additional cash withdrawals are made from the U.S. Treasury.

During the period from August 2006 to July 2008, there was at least $1.5 million of available program income in the County's bank account, except for in May 2008, which had $964,232 of available program income because of the inappropriate transfer of program income to pay County-wide pension costs (see below). Despite this large balance in program income, County officials unnecessarily drew down funds from HUD as follows. From August 2006 through July 2008, the County drew down $929,507 for its multi jurisdictional rehabilitation program and during March 2007 to July 23, 2007, $366,333 was drawn down for the senior home improvement program even though program income was available to be disbursed. Therefore, if the County complied with the above regulation, it would have eliminated $1,295,840 ($929,507 + $366,333) of unnecessary draw downs.

Program Income Used for Pension and Other Non-CDBG-Related Costs

During the period April-May 2008, County officials transferred $130,000 from CDBG funds and $1.5 million in program income to its current fund to pay County-wide employee pension costs. Regulations at 24 CFR 570.207(a)(2) state that expenses required to carry out the regular responsibilities of the unit of general local government are not eligible for assistance under this part. Therefore, County officials inappropriately transferred more than $1.6 million to pay County-wide pension costs that were not related to the CDBG program. Although County officials later repaid the $1.6 million that they transferred from program income and CDBG accounts, these transfers were not allowed.

In addition, during program year 2006, County officials may have spent $438,793 in program income for other non-CDBG-related activities. Officials of the County's finance department claimed that the $438,793 payment was a reimbursement of prior program costs paid by the County's other funding sources since the County's community development program was short of funds at the time. However, officials of the County's finance department were unable to substantiate their claim with documentation showing that the $438,793 consisted of eligible CDBG costs. Regulations at 24 CFR 570.200(a) require that an activity be assisted in whole or in part with CDBG funds only if it meets one of the CDBG national objectives. Since County officials did not provide support for these transfers, there is no assurance that these costs met one of the national objectives. As a result, $438,793 in disbursements of program income is considered unsupported.

Program Income Used for Unsupported Disbursement

County officials could not support a drawdown of $25,000 from program income. Officials allocated $310,000 in CDBG funds to the City of Rahway, a subgrantee, for its CDBG housing rehabilitation program during program year 2005. The drawdown report for this activity showed a total drawn-down amount of $335,000, which included $25,000 in program income. However, the County's and subgrantee's files did not contain supporting documents for the $25,000.

Regulations at 24 CFR 85.20(b)(6) require that accounting records be supported by source documents such as cancelled checks and paid bills. In addition, regulations at 24 CFR 570.506(h) requires recipients to maintain evidence to support how CDBG funds provided were expended. Such documents must include, to the extent applicable, invoices and schedules comparing budgeted amounts with actual expenses.

The subgrantee stated that County officials may have erroneously drawn down an additional $25,000, thus showing a total $335,000 for the City of Rahway's activity. In the absence of supporting documents, the eligibility of $25,000 drawn down could not be determined.

Program Income Not Recorded and Reported Accurately

County officials did not record and report the receipts of program income accurately in IDIS, which may also have affected the County's timeliness ratio.

The County generates program income from its CDBG multijurisdictional housing rehabilitation program. The Cities of Rahway, Linden, and

Plainfield are subgrantees of the County that also generate program income. During program year 2005, County officials did not report more than $1.2 million in program income, which included $443,515 of the County's own program income. In program year 2006, County officials did not report $537,267 in program income generated by its subgrantees but overstated the subgrantees' program income by $664,852 during program year 2007. Therefore, County officials did not accurately record more than $1.1 million[1] in program income in IDIS.

County officials may also not have been aware of HUD's requirements for financial reporting. Regulations at 24 CFR 570.504(a) and (b) require that receipts and expenditures of program income as defined in section 570.500(a) be recorded as part of the financial transactions of the grant program and be subject to all applicable requirements governing the use of CDBG funds. Based on the above, County officials could not assure HUD that they accurately recorded receipts and expenditures of program income in IDIS.

Further, regulations at 24 CFR 570.902(a)(2)(i) provide that HUD may determine that the recipient is not carrying out its activities in a timely manner if the amount of CDBG program income the recipient has on hand 60 days before the end of its current program year, together with the amount of funds in its CDBG line of credit, exceeds 1.5 times the entitlement grant amount for its current program year. Records indicated that the County's cash on hand already exceeded 1.5 times its entitlement grant; however, if the underreported program income of more than $1.1 million is added to the line of credit balance for program year 2008, the County's timeliness ratio would increase from 2.17 to 2.39; thus, the County did not disburse its funds in a timely manner.

Inadequate Monitoring of Consultant

Contrary to federal regulations, County officials did not appear to adequately monitor the County's consultant to ensure compliance with federal regulations. For instance, the consultant that carries out the County's CDBG multijurisdictional rehabilitation program invested escrow funds in a non-interest-bearing account. Regulations at 24 CFR 570.511 require that funds held in an escrow account be deposited into an interest-bearing account and that the amount of funds deposited into an escrow account be limited to the amount expected to be disbursed within 10 working days from the date of deposit. If the escrow account, for whatever reason, contains funds exceeding 10 days' cash needs, the

[1] $1,263,726 plus $537,267 in program income not reported minus $664,852 in overstated program income equals $1,136,141.

grantee should immediately transfer the excess funds to its program account.

Regulations at 85.20(b)(7) require the grantee to make drawdowns as close as possible to the time of making disbursements. However, the consultant's bank statements for program years 2006 and 2007 showed that the consultant maintained an average monthly bank balance of $164,472. It did not disburse funds to contractors for approximately two to seven months after receiving funds from the County.

For three of five rehabilitation project files reviewed, the County drew down and transferred to the consultant $67,542 based on the vouchers the consultant submitted. However, the consultant disbursed $51,599 to the contractors who performed the work. Instead of returning the remaining $15,943 to the County, the consultant retained the funds for several years. For another rehabilitation project, the County drew down $78,787 during July and August 2006; however, it had not paid a balance of $15,908 to the contractor. Since the $31,851 ($15,943 + $15,908) had not been spent by the consultant but sat idle in the consultant's bank account, these funds appear to have been unnecessarily drawn down and should be remitted to the County.

Conclusion

Weaknesses existed in the County's financial and monitoring controls. As a result, County officials unnecessarily drew down over $1.2 million in CDBG funds, transferred more than $1.6 million for non-CDBG uses, disbursed more than $438,000 in program income for unsupported items, did not support a $25,000 drawdown in IDIS, did not adequately record or report $1.1 million in program income, and did not adequately monitor its consultant to ensure that excess drawdowns of more than $31,000 were returned to the County. We attribute this condition to County officials' unfamiliarity with HUD regulations that led to the development of inadequate controls to safeguard funds and ensure compliance.

Recommendations

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

1A. Establish procedures for using separate revolving accounts for program income, as defined by 24 CFR 570.500(b), and ensure that disbursements of program income amounts are in accordance with 24 CFR 85.21(f)(1) and 24 CFR 570.504(b)(2)(ii).

1B. Instruct its finance department to discontinue its practice of transferring CDBG funds and program income amounts to other County accounts for non-CDBG disbursements.

1C. Reimburse the program income account $438,793 from nonfederal sources if the County cannot provide documentation supporting that the amount was a repayment of CDBG-eligible expenses initially paid with the County's other funds.

1D. Provide documentation to support the eligibility of the $25,000 in unsupported drawdowns of program income or repay any amounts determined to be ineligible.

1E. Establish procedures for ensuring that each drawdown is supported with adequate documentation.

1F Establish and implement procedures for properly recording receipts and disbursements of program income in IDIS as required by 24 CFR 570.504(a) and (b).

1G. Establish controls to ensure available program income is used before drawing down funds from HUD's line of credit.

1H. Develop and implement proper policies and procedures to ensure that program income is properly recorded and reported, including the $1,136,141 that had not been reported in IDIS, so that HUD can be assured that these funds will be put to better use by eliminating unnecessary drawdowns from the entitlement grant.

1I. Establish procedures for ensuring that funds held in escrow accounts by the consultant are invested in an interest-bearing account and are disbursed within 10 business days from the date of deposits, and if not disbursed for any reason, the funds should be transferred back to the County as required by 24 CFR 570.511.

1J. Direct the consultant to remit $31,851 to the County to be put back into the County's line of credit since the funds were not disbursed by the consultant and, therefore, drawn down unnecessarily.

1K. Develop a policy to reconcile amounts advanced and expended by its consultant for each rehabilitation project before disbursing additional funds to the consultant.

1L. Establish procedures to periodically monitor the consultant's activities to ensure compliance with CDBG rules and regulations.

1M. Require its finance department to establish procedures for complying with HUD's standards for financial management systems at 24 CFR 85.20.

SCOPE AND METHODOLOGY

To accomplish our objectives, we:

- Reviewed applicable laws, regulations, and HUD program requirements at 24 CFR Parts 85 and 570 .
- Analyzed the County's funding and drawdown information for CDBG funds and program income in HUD's Line of Credit Control System (LOCCS) and IDIS.
- Reconciled the County's consolidated annual performance and evaluation report (CAPER) project activities with actual financial data schedules, cancelled checks, and other payment information.
- Reviewed HUD's monitoring reports and administrative files for the County's CDBG program.
- Conducted interviews with the County's administrative and finance staff to gain an understanding of the internal controls related to the administration of its CDBG program.
- Reviewed the County's program policies and procedures, its CAPER and action plans, annual audited financial statements, funding agreements, board of freeholder minutes, budgets, general ledgers, contract registers, LOCCS drawdowns, and vouchers related to the CDBG program.
- Selected a nonstatistical sample of 24 out of 189 project activities that were completed or underway via the use of Audit Command Language (ACL) and reviewed the related files to ensure compliance with program regulations and procedures.
- Conducted interviews and inquiries with HUD's Office of Community Planning and Development field office officials to obtain an understanding of the County's CDBG program.

We performed our audit fieldwork between August 2008 and January 2009 at the County's Department of Parks and Community Development administrative offices located at 10 Elizabethtown Plaza, Elizabeth, New Jersey. Our audit generally covered the period August 1, 2006, through July 31, 2008, and was expanded as necessary.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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 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 audit, we believe that the following items are significant weaknesses:

- The County did not ensure compliance with laws and regulations as it did not always comply with HUD regulations for drawing down funds from the CDBG line or credit and for the usage of program income (see finding).

- The County did not always properly safeguard resources when it allowed its consultant to retain excess cash balances and did not use its program income balances before drawing down funds from the CDBG line of credit (see finding).

- The County did not always ensure that valid and reliable data were reported to HUD when program income was not properly recorded and reported in IDIS (see finding).

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/
1C		$438,793	
1D		$25,000	
1H			$1,136,141
1J	$31,851		
Total	$31,851	$463,793	$1,136,141

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.

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. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this case, if County officials establish controls to ensure that available program income is used before drawing down funds from HUD's line of credit, it will eliminate unnecessary drawdowns, which will result in the effective use of $1,136,141 in program income, representing funds to be put to better use.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

COUNTY OF UNION

DEPARTMENT OF PARKS & COMMUNITY RENEWAL
Alfred J. Faella, Director (908) 527-4027

May 4, 2009

Edgar Moore, Regional Inspector General for Audit, New York/New Jersey
U.S. Department of Housing & Urban Development
Office of Inspector General
One Newark Center, 13th floor
Newark, NJ 07102

RE: Audit Report Number 2009-NY-10XX
Issue Date: May 2009

Dear Mr. Moore:

In response to your request, below please find Union County's written response to the above referenced draft audit report.

On page two of the draft audit, the OIG stated:

"We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the County to (1) establish controls to ensure the available program income is issued before drawing down funds from HUD's line of credit, (2) reimburse the program income account $438,793 from nonfederal sources if the County cannot provide supporting documentation, (3) implement policies and procedures to ensure that the program income is accurately recorded and reported, and (4) instruct its consultant to remit $31,851 to the County to be put back into the County's line of credit since the funds were not disbursed."

County Response

Comment 1 — 1. Establish control to ensure that available program income is used before drawing down funds from HUD's line of credit.

The County has already implemented a system to ensure that program income funds are spent prior to requesting entitlement funds. As of today, all of the program income funds highlighted by OIG have already been receipted, expended and reported in the IDIS system.

Additionally, the County has retained the professional services of a HUD approved consultant specializing in IDIS requirements and HUD regulations. The

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

consultant will continue to work with the County to ensure that program income funds are administered correctly.

Finally, the County has inaugurated a monthly meeting schedule between the Department of Finance and the Department of Parks & Community Renewal, Division of Planning and Community Development to ensure regular communication, planning and financial transactions/decisions on a joint basis.

2. Reimbursement of $438,793 to program income account.

Comment 2

Funds in the amount of $348,994.31 were reimbursed on February 26, 2009. The balance of $89,798.69 will be returned on May 6, 2009. A copy of the reimbursement is being mailed to the Office of OIG for their record.

3. Implement policies and procedures to ensure that program income is accurately recorded and reported.

Comment 1

A separate bank account has been established to receive program income funds. Upon receipt, the funds are recorded in the IDIS system and will be expended prior to drawing down any entitlement funds.

4. Instruct its consultant to remit $31, 851.

Comment 3

A check in the amount of $15,628 was received on December 18, 2008. The balance due will be paid on May 7, 2009.

We would like to thank the OIG for their guidance and recommendations. The OIG staff was hard working and professional. Please know that all of the OIG recommendations (as listed on pages 10-11 of the OIG report) have already been, or shortly will be, implemented.

Should you have any questions, please feel free to contact me at (908) 527-4027.

Very truly yours,

Alfred J. Faella, Director
Union County Department of Parks & Community Renewal

C: Lawrence M. Caroselli, Director
Union County Department of Finance

OIG Evaluation of Auditee Comments

Comment 1 The Auditee's comments and planned actions are responsive to our recommendations.

Comment 2 County officials indicated that $348,994.31 had already been reimbursed and the balance of $89,798.69 would be reimbursed to its CDBG program. As such, these repayments should be verified by the Field Office during the audit resolution process.

Comment 3 County officials indicated that a check in the amount of $15,628 was deposited and the balance will be remitted to the County's line of credit. As such, these repayments should be verified by the Field Office during the audit resolution process.