



Commonwealth of Kentucky, Frankfort, KY

Neighborhood Stabilization Program Grants 1 and 3



To: Jessie H. Kome, Acting Director, Office of Block Grant Assistance, DGB

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

Subject: The Commonwealth of Kentucky Generally Administered Its Neighborhood Stabilization Program in Accordance With HUD Requirements

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

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

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

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



Audit Report Number: 2018-AT-1001

Date: December 21, 2017

The Commonwealth of Kentucky Generally Administered Its Neighborhood Stabilization Program in Accordance With HUD Requirements

Highlights

What We Audited and Why

We audited the Commonwealth of Kentucky's (Commonwealth) administration of the U.S. Department of Housing and Urban Development's (HUD) Neighborhood Stabilization Program (NSP) based on a referral from the Louisville, KY, Office of Community Planning and Development and in accordance with our annual audit plan. Our objective was to determine whether the Commonwealth administered its NSP1 and NSP3 grants in accordance with HUD's requirements.

What We Found

The Commonwealth generally administered its NSP1 and NSP3 grants in accordance with HUD's requirements to (1) ensure grant activity eligibility, (2) record and use program income, and (3) report on its grants' performance to HUD. However, the Commonwealth did not ensure that proper support for all activity disbursements was maintained by its subrecipient. Specifically, of the 69 disbursements reviewed for 15 NSP activities, 3 disbursements for 1 activity lacked adequate support. In addition, the Commonwealth's records retention policy for the grants was not adequate to meet HUD's requirements for records retention. These conditions occurred because the Commonwealth lacked (1) a strategy to address subrecipients' storage needs and (2) an understanding of HUD's requirements for records retention. As a result, HUD and the Commonwealth lacked assurance that nearly \$54,000 in grant activity disbursements was used for appropriate expenses. Further, additional program expenses may be inadequately supported.

What We Recommend

We recommend that HUD's Acting Director of the Office of Block Grant Assistance require the Commonwealth to (1) provide support adequate to HUD or reimburse its program subrecipient nearly \$54,000 from non-Federal funds for the inadequately supported disbursements, (2) update its records retention policy to meet HUD's records retention requirements and notify its subrecipients, and (3) develop a retention strategy for its subrecipients to ensure that documentation is readily available for review.

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Background and Objective

The Neighborhood Stabilization Program (NSP), authorized under Title III of the Housing and Economic Recovery Act of 2008 (HERA), authorized \$3.92 billion to States and units of general local government for the redevelopment of abandoned and foreclosed-upon homes and residential properties that might otherwise become sources of abandonment and blight within their communities. The U.S. Department of Housing and Urban Development (HUD) awarded grants, on a formula basis, to 309 grantees to stabilize communities hardest hit by foreclosures and delinquencies. Further, on July 21, 2010, Section 1497 of the Dodd-Frank Wall Street Reform and Consumer Protection Act provided an additional \$1 billion to States and local governments to continue assisting them in the redevelopment of abandoned and foreclosed-upon homes. HUD awarded the grants on a formula basis.

Under HERA, the Commonwealth of Kentucky (Commonwealth) received \$37.4 million in NSP1 funds, and under the Dodd-Frank Act, the Commonwealth received \$5 million in NSP3 funds in March 2009 and March 2011, respectively. The Commonwealth's Department for Local Government was responsible for administering both NSP grants.

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

- Establishing financing mechanisms for the purchase and redevelopment of foreclosed-upon homes and residential properties, including subsidized second mortgages, loan loss reserves, and shared equity loans for low- and moderate-income home buyers.
- Purchasing and rehabilitating homes and residential properties that have been abandoned or foreclosed upon to sell, rent, or redevelop such homes and properties.
- Establishing land banks for homes that have been foreclosed upon.
- Demolishing blighted structures and redeveloping demolished or vacant properties.

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

Results of Audit

Finding: The Commonwealth Generally Administered Its Neighborhood Stabilization Program in Accordance With HUD's Requirements

The Commonwealth generally administered its NSP1 and NSP3 grants in accordance with HUD's requirements to (1) ensure grant activity eligibility, (2) record and use program income, and (3) report on its grants' performance to HUD. However, the Commonwealth did not ensure that proper support for all activity disbursements was maintained by its subrecipient. In addition, the Commonwealth's records retention policy for the grants was not adequate to meet HUD's requirements for records retention. These conditions occurred because the Commonwealth lacked (1) a strategy to address its subrecipients' storage needs and (2) an understanding of HUD's requirements for records retention. As a result, HUD and the Commonwealth lacked assurance that nearly \$54,000 in grant activity disbursements was used for appropriate expenses. Further, additional program expenses may be inadequately supported.

Grant Activity Disbursements Not Adequately Supported

We reviewed 69 disbursements¹ totaling nearly \$1.58 million for 15 combined NSP1 and NSP3 activities to determine whether the disbursements were eligible and adequately supported. The Commonwealth did not ensure that three disbursements totaling \$53,760 for one NSP3 activity was adequately supported for a property located in Paducah, KY. This condition occurred because the Commonwealth lacked a strategy to address its subrecipient's storage needs. Due to a lack of space, the Commonwealth's policies and procedures required its subrecipients to retain all original supporting documentation, which was reviewed by the Commonwealth during monitoring reviews on sampled disbursements or occasionally with payment requests. However, the supporting documentation was not required to be submitted with each payment request except as needed by the reviewer. The Commonwealth's subrecipient for the activity, Purchase Area Housing Corporation (PAHC), explained that it had difficulty locating the supporting documentation because none of the staff related to its NSP projects remained with the organization and the records pertaining to the activity had been moved twice since its staff left. In addition, PAHC's original contractor no longer did business in the area, and PAHC was unable to find current contact information to request a copy of any invoices from the contractor. As a result, HUD and the Commonwealth lacked assurance that nearly \$54,000 in grant activity disbursements was used for appropriate expenses.

Records Retention Requirements Not Adequate

The Commonwealth's records retention policy was not adequate to meet HUD's requirements. HUD required² that records, including supporting documentation, be retained for 3 years from

¹ Our methodology for the sample selection is explained in the Scope and Methodology section of this audit report.

² 24 CFR (Code of Federal Regulations) 570.490(d)

the closeout of the NSP grants. However, the Commonwealth required³ its subrecipients to maintain records for 5 years from activity closeout, which could occur before the grant closeout. The Paducah activity closed in November 2013, but the NSP1 and NSP3 grants had not closed at the time of our review in 2017. Therefore, the records retention period had not exceeded either the Commonwealth's 5-year requirement from activity closeout or HUD's 3-year requirement from grant closeout. As a result, the supporting documentation should still have been maintained.

As stated above, the Commonwealth lacked a strategy to address its subrecipient's storage needs. However, the Commonwealth's records retention policy did not comply with HUD's records retention policy because the Commonwealth misunderstood the requirements. The Commonwealth's internal policy analyst explained that the Commonwealth followed HUD's records retention requirements for subrecipients under the Community Development Block Grant (CDBG) program, which was acceptable according to HUD's requirements.⁴ However, the CDBG program requirements⁵ provide a records retention period of 3 years from grant closeout and not 5 years from activity closeout. The NSP closeout guide published by HUD recommended a records retention period of 5 years from the date of closeout. However, the guide also referenced the closeout of the NSP grant and not a project.

Unless the Commonwealth formally updates its records retention policy to meet HUD's records retention requirements and develops a retention strategy for its subrecipients to ensure that HUD funding records are readily available for review, additional program expenses may be inadequately supported.

Conclusion

The Commonwealth did not have a strategy to ensure that storage needs were appropriately addressed for its subrecipients. In addition, the Commonwealth's retention requirements for records were not adequate to meet HUD's requirements for records retention because the Commonwealth lacked an understanding of HUD's requirements. As a result, HUD and the Commonwealth lacked assurance that \$53,760 in NSP3 grant activity disbursements was used for appropriate expenses, and additional program expenses may be inadequately supported.

Recommendations

We recommend that HUD's Acting Director of the Office of Block Grant Assistance require the Commonwealth to

- 1A. Adequately support or reimburse its NSP3 grant subrecipient \$53,760 from non-Federal funds for the disbursements not adequately supported.
- 1B. Update its records retention policy to meet HUD's records retention requirements and notify its NSP subrecipients of the documentation retention requirements for the NSP grants.

³ Section 8(A)(2) of funding agreement

⁴ HUD's unified NSP1 and NSP3 notice provides that statutory and regulatory provisions governing the CDBG program for grantees apply to the use of NSP funds.

⁵ See footnote 2.

- 1C. Develop a retention strategy for its subrecipients to ensure that documentation is readily available for review.

Scope and Methodology

We performed our onsite audit work between March 28 and June 30, 2017, at the Commonwealth's Department for Local Government office located at 1024 Capital Center Drive, Frankfort, KY. The audit generally covered the period March 1, 2009, through April 13, 2017.

To accomplish our objective, we reviewed HUD's, the Commonwealth's, and its subrecipients' files; HUD's requirements; and the Commonwealth's policies and procedures and interviewed HUD and Commonwealth staff.

From a universe of 290 unique NSP1 and NSP3 activity numbers for the period January 1, 2009, through March 24, 2017, we statistically selected 60 NSP activities and reviewed 15 activities that had 69 disbursements totaling nearly \$1.58 million. We reviewed the activities to determine whether they were eligible, and the associated disbursements for the activities were properly supported. For the review of adequately supported activities, we limited our review to all disbursements over \$5,000 within each of the 15 statistically selected activities with 1 exception.⁶ We determined that all 15 activities were eligible and 14 activities had adequate documentation to support them. Therefore, we did not review the remaining 45 (60 – 15) activities because a systematic issue was not noted in the 15 activities reviewed. As a result, the results of the 15 activities are attributable only to those specific items and cannot be projected to the universe of transactions.

We relied in part on computer-processed data contained in the Commonwealth's system to achieve our audit objective. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes. The tests included but were not limited to comparing computer-processed data to project disbursement amounts, program income uses and program income receipts, and other supporting documentation in the project activity files.

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

⁶ We reviewed one disbursement for adequate support even though it totaled less than \$5,000 because it was one of the statistically selected items.

Internal Controls

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

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

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

Relevant Internal Controls

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

- Effectiveness and efficiency of operations – Policies and procedures that the management has implemented to reasonably ensure that a program meets its objectives, while considering cost effectiveness and efficiency.
- Relevance and reliability of information – Policies and procedures that management has implemented to reasonably ensure that operational and financial information used for decision making and reporting externally is relevant, reliable, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that program implementation is consistent with laws and regulations.

We assessed the relevant controls identified above.

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

We evaluated internal controls related to the audit objectives in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the Commonwealth's internal controls.

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A	\$53,760
Totals	53,760

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

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG
Evaluation

Auditee Comments



**OFFICE OF THE GOVERNOR
DEPARTMENT FOR LOCAL GOVERNMENT**

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Sandra K. Dunahoo
Commissioner

November 21, 2017

Ms. Nikita N. Irons
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
75 Ted Turner Drive S.W., Room 300
Atlanta, Georgia 30303

Dear Ms. Irons:

The Department for Local Government (DLG) and the Commonwealth of Kentucky are committed to operating the HUD Community Development Block Grant Program, and in particular, the Neighborhood Stabilization Program (NSP) with integrity and with the fiduciary responsibility that is required for the investment of federal program dollars. The purpose of this correspondence is to outline a sequence of events related to supporting documentation for three invoices processed by Purchase Area Housing Corporation (PAHC) for a NSP project located at 1329 Park Avenue.

The Purchase Area Housing Corporation (PADD), the former housing division of the Purchase Area Development District (PADDD), contracted to build a home through the NSP program at 1329 Park Avenue in March 2012. The house was completed and sold in 2013. DLG contacted PADD in the summer of 2017 to produce documentation on the 1329 Park Avenue home as part of the NSP program. PADD provided all supporting documentation for several NSP units with the exception of three contractor invoices from 1329 Park Avenue. The three expenditures were supported via fund transfer from DLG to PADD ending with payment to the contractor and the housing unit was completed, however, PADD could not produce copies of the three contractor invoices.

Per the request of DLG, PADD has conducted an extensive search of its housing files to locate the missing invoices; such efforts have been unsuccessful. PADD indicates the following mitigating factors impacted the agency's ability to provide the requested documentation:



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Comment 1

- First, the contractor for the project filed bankruptcy, is out-of-business, has moved out-of-state, and cannot be located. PADD also tried to locate the contractor in June 2014 when issues arose related to another property he had built. This attempt was also futile.
- Second, at the end of 2013, PADD curtailed any activities conducted in the housing area. All full-time staff in the housing area left the employ of PADD by December 2013. Since that time, PADD worked to divest themselves of any property owned by the PAHC. All the staff directly working with the NSP project have been gone for almost four years. All files on this project have been boxed and in storage since 2013.
- Third, the only documents that were unable to be located are the invoices from the contractor on this particular unit. The unit sold during the transition of the housing staff leaving employment. PADD has all bank statements, canceled checks, along with an internal request for payment produced for each transaction. The PADD internal processes included a review and approval by the housing program staff of all work completed. The approval, along with documentation, was provided to the PADD finance office who issued the checks on all project work.

The situation of the contractor filing bankruptcy, PADD closing housing activities, a complete loss of staff knowledge related to the project and relocation of paper files related to the project, creates a unique set of circumstances related solely to this particular NSP project.

The Commonwealth of Kentucky respectfully submits the above-detailed explanation for your consideration and review. If further information is necessary, please contact this office.

Sincerely,



Sandra K. Dunahoo
Commissioner

OIG Evaluation of Auditee Comments

Comment 1 The Commonwealth outlined a sequence of events and factors preventing its subrecipient from being able to provide documentation to support program disbursements.

As stated in the audit report, as a result of missing documentation, HUD and the Commonwealth lacked assurance that program disbursements were used for appropriate expenses. Therefore, the Commonwealth should work with HUD to ensure that it adequately supports or reimburses its NSP3 grant subrecipient from non-Federal funds for the disbursements not adequately supported.