



**Morris County, NJ**

**Community Development Block Grant Program**



Issue Date: January 23, 2013

Audit Report Number: 2013-NY-1003

TO: Anne Marie Uebbing  
Director, Office of Community Planning and Development, Newark Field Office,  
2FD

FROM: *Edgar Moore*  
Edgar Moore  
Regional Inspector General for Audit, New York-New Jersey, Region, 2AGA

SUBJECT: Morris County, NJ's Community Development Block Grant Program Had  
Weaknesses in Its Financial and Administrative Controls

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the Morris County, NJ officials' administration of their Community Development Block Grant (CDBG) Program to determine whether Authority officials administered the CDBG Program in accordance with HUD requirements.

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 8L, requires that OIG post its publicly available reports on the OIG Web site. 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 212-264-4174.



January 23, 2013

## Morris County, NJ's Community Development Block Grant Program Had Weaknesses in Its Financial and Administrative Controls

# Highlights

Audit Report 2013-NY-1003

### What We Audited and Why

We audited Morris County, NJ's Community Development Block Grant (CDBG) program based on a risk assessment, which considered the size of the program, the U.S. Department of Housing and Urban Development's (HUD) risk analysis, and prior audit coverage. The objectives of the audit were to determine whether County officials established adequate controls to ensure that CDBG funds were expended for eligible activities and that the program was administered in accordance with HUD regulations.

### What We Recommend

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct County officials to (1) provide documentation to support the obligation and expenditure of \$140,705 or reimburse the County's CDBG line of credit, (2) reimburse the County's CDBG line of credit for the \$19,500 in ineligible assistance, (3) record a lien or other notice of record on the real property acquired with CDBG funds, and (4) strengthen financial and administrative controls to ensure that CDBG funds are used in accordance with applicable regulations.

### What We Found

County officials generally expended CDBG funds for eligible activities, but weaknesses in financial and administrative controls lessened assurance that program administration always complied with HUD regulations and HUD's interest was protected. Specifically, (1) CDBG funds were obligated or expended for ineligible or unsupported activities, (2) the County's action plan was not properly amended, (3) financial information was not always accurate (4) subrecipients were not always monitored in compliance with HUD regulations and the County's policies, and (5) liens were not imposed on assisted properties. Consequently, (1) \$140,705 was obligated and expended for unsupported activities, and \$19,500 was expended for ineligible activities; (2) neither the public nor HUD was aware of the change in the use of more than \$400,000 for previously approved activities; (3) County officials lacked assurance that the financial data submitted by the County accurately reflected its performance; (4) subrecipients were not effectively monitored to ensure that the activities had been accomplished according to program requirements; and (5) HUD's interest in a property assisted with \$71,729 in CDBG funds was not protected. These conditions existed due to County officials' unfamiliarity with CDBG regulations and implementation of inadequate financial and administrative controls.

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## **BACKGROUND AND OBJECTIVES**

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The Community Development Block Grant (CDBG) program was authorized by Title 1 of the Housing and Community Development Act of 1974 (Public Law 93-383) to provide communities with resources to address a wide range of unique community development needs. The program provides grants on a formula basis to entitled States, cities, and counties to develop viable urban communities by providing decent housing, suitable living environments, and expanding economic opportunities, principally for low- and moderate-income persons. Grantees have the flexibility to develop their own programs and funding priorities. However, to be eligible for CDBG funding, a grantee's activity (other than program administration and planning) must meet one of the CDBG program's three national objectives: (1) benefit low- and moderate-income persons, (2) aid in preventing or eliminating slums or blight, or (3) address a need with a particular urgency that poses a serious and immediate threat to the health and welfare of the community for which other financial resources are not available to meet such needs.

Morris County, located in northern New Jersey, has 492,276 residents spread among 39 municipalities. The County is governed by a seven-member Board of Chosen Freeholders, elected to 3-year terms. The Freeholder Board sets policies that are carried out by the county administrator working through six umbrella departments, which form a "cabinet" to conduct day-to-day operations.

The U.S. Department of Housing and Urban Development (HUD) awarded Morris County more than \$2.4 and \$2 million in CDBG funds for program years 2010 and 2011, respectively. The County designated the Division of Community Development under the Department of Planning and Development to administer its CDBG program. In addition to administrative costs, the County's CDBG funds are mainly allocated to four major activities: housing, public services, public facilities and improvements, and homeowner rehabilitation. County officials implement these activities through various agencies, as well as with municipalities and nonprofit organizations.

The objectives of the audit were to determine whether County officials established adequate controls to ensure that CDBG funds were expended for eligible activities and that the program was administered in accordance with HUD regulations.

# RESULTS OF AUDIT

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## Finding 1: Funds Were Generally Expended for Eligible Activities

While County officials generally expended CDBG funds for eligible activities, disbursements were made for ineligible and unsupported activities, and financial data were not always accurately maintained. Specifically, County officials disbursed \$19,500 for an ineligible loan, \$209,735 for costs that were inadequately supported, and \$10,970 for unreasonable or unnecessary costs, and officials inaccurately reported financial data to HUD. These conditions occurred because of officials' unfamiliarity with HUD regulations and implementation of inadequate financial and administrative controls. As a result, funds were not available for other eligible activities, and County officials lacked assurance that all costs incurred were for eligible activities and that financial data submitted to HUD accurately reflected its performance.

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### Rehabilitation Loan to Ineligible Homeowner

County officials disbursed \$19,500 to a homeowner who was ineligible for a housing rehabilitation loan. The County's housing rehabilitation loan program disbursed funds to provide decent housing for low- and moderate-income homeowners who reside within the participating municipalities of the Morris County Consortium, and the County's policy requires that assisted homeowners not own more than one property. However, the County's application form did not advise applicant homeowners that they were required to disclose ownership of additional properties or to certify that the information provided was truthful. As a result, one homeowner received a \$19,500 loan for septic system rehabilitation while owning another property in the County, thus preventing \$19,500 from being available for eligible CDBG rehabilitation loans.

### Inadequately Supported Drawdown and Disbursements

County officials lacked documentation that \$49,735 was drawn down for an eligible activity. Regulations at 24 CFR (Code of Federal Regulations) 85.21 specify that Federal funds must be administered on a reimbursement basis, and regulations at 2 CFR Part 225 require that allowable costs be adequately documented. However, County officials drew down funds for the housing rehabilitation program based on estimated costs rather than reimbursement of actual costs. As a result, they drew down \$49,735 more than the actual disbursements recorded in the general ledger for program years 2009 and 2010. This deficiency occurred because County officials lacked controls to ensure that

the use of funds was adequately supported and drawdowns were made as close as possible to the time of making disbursements.

In addition, County officials reimbursed \$80,000 to a subrecipient for a street improvement project without adequate support that the project had been completed and the associated costs were incurred for the benefit of the low- and moderate-income area specified in the subrecipient agreement. The project was multisource funded, and reimbursement was made without adequate documentation that the \$80,000 in CDBG funds was for the CDBG-assisted portion. As a result, County officials lacked assurance that the \$80,000 was used for the CDBG-funded portion and benefited only the low- and moderate-income area. This deficiency occurred because weaknesses in financial controls allowed officials to disburse funds without assurance that the program requirements were met and the use of CDBG funds was properly supported. County officials agreed that the supporting documentation was not adequate and during our audit, obtained additional documents from the subrecipient that adequately supported the \$80,000 disbursement, thus ensuring that these funds were used for their intended purpose.

County officials awarded another \$80,000 for a public improvement project without adequate documentation showing that it would primarily benefit low- and moderate-income residents. While County officials conducted a survey to identify low- and moderate-income residents, the survey was not conducted in accordance with 24 CFR 570.208. These regulations require that the survey be conducted in a manner that meets standards of statistical reliability that are comparable to those of the decennial census<sup>1</sup> data and be approved by HUD. However, while the survey was designed to be conducted for 61 households, the results were based upon 51 responses; therefore, the survey did not meet the standards of statistical reliability. In addition, the survey was not reviewed by HUD to determine its reasonableness and accuracy. This deficiency occurred because County officials were not aware of CDBG program requirements related to conducting a survey to determine a low- and moderate-income service area. Therefore, County officials lacked assurance that the \$80,000 awarded for the public improvement was an eligible use of CDBG funds.

### **Unreasonable or Unnecessary Cost**

County officials awarded a subrecipient \$10,970 more in CDBG funds than requested for a public facility improvement activity to replace carpet at a health facility. Subpart C of 2 CFR Part 225 states that costs must be necessary and reasonable to be allowable under Federal awards. However, in this instance, the

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<sup>1</sup> A decennial census is conducted every 10 years, as required by the U.S. Constitution, and is used to make decisions affecting legislation and Federal spending on projects and programs that are vital to the health and welfare of the U.S. population and economy.

total cost of the project was estimated to be \$21,000, and the subrecipient requested \$9,030 to supplement the \$11,970 it was going to receive from another source. However, County officials awarded \$20,000 because the County's policy provides that the minimum grant for a public facility improvement is \$20,000. As a result, County officials could not assure HUD that the \$10,970 was incurred for reasonable or necessary costs.

### **Inaccurate Financial Reporting**

Regulations at 24 CFR 85.20 require that CDBG recipients maintain a financial management system that provides accurate, current, and complete records of financial results. However, the County's records did not always reflect the results of actual operations or reconcile with what was reported to HUD. For example, County records for program year 2009 reported \$3,500 more in program income than was earned. Additionally the County's action plan for 2010 did not include \$100,000 for rehabilitation delivery costs. The summary of the County's consolidated annual performance and evaluation report for program year 2010 stated that total expenditures would be less than \$1.2 million, while the supplemental report indicated that the expenditures were more than \$2.5 million. As a result, HUD was not provided with accurate data to adequately evaluate the performance of the County's CDBG program. These inaccuracies resulted from insufficient controls over financial reporting and human error. Upon being informed of these issues during our audit, County officials agreed to correct them.

### **Conclusion**

County officials generally expended CDBG funds for eligible activities; however, officials' unfamiliarity with HUD regulations and implementation of inadequate financial and administrative controls resulted in some ineligible, unreasonable, and unsupported costs, as well as inaccurate reporting. As a result, County officials could not assure HUD that all disbursements were for eligible activities and the financial data submitted to HUD accurately reflected the County's performance.

### **Recommendations**

We recommend that the Director of HUD's Newark, NJ, Office of Community Planning and Development instruct County Officials to

- 1A. Reimburse the County's CDBG line of credit from non-Federal funds for the \$19,500 disbursed for an ineligible rehabilitation loan.
- 1B. Strengthen controls over the County's homeowner rehabilitation loan application procedures by revising the application to inform applicants of the prohibition against ownership of another property and include a reference to



possible imposition of civil monetary penalties under the False Claims Act for anyone providing false information.

- 1C. Provide documentation to support that the \$49,735 drawdown was expended for eligible CDBG costs and if such support cannot be provided, repay the amount from non-Federal funds.
- 1D. Strengthen controls over reimbursement procedures to ensure that disbursement of CDBG funds, such as the \$80,000 that was disbursed for the street improvement project without adequate support, is made based upon documentation adequate to ensure that the funds were used for eligible purposes and the costs incurred were reasonable and properly supported, thus ensuring that these funds were used for their intended purpose.
- 1E. Provide documentation to support that the \$80,000 obligated for the public improvement project is an eligible expense. If it is not deemed eligible, the funds should be deobligated.
- 1F. Strengthen the County's internal controls to ensure that the County documents support that CDBG funds will be used to assist projects in a low- and moderate-income service area in accordance with the CDBG program requirements before obligating and disbursing the funds.
- 1G. Provide documentation showing that the \$10,970 disbursed in excess of a subrecipient's request was reasonable and necessary. If it is deemed unreasonable or unnecessary, the funds should be repaid to the County's CDBG line of credit from non-Federal funds.
- 1H. Strengthen internal controls over the County's financial reporting to ensure that financial information submitted to HUD is accurate, current, and complete.
- 1I. Request CDBG financial management training from the HUD Office of Community Planning and Development's field office staff.

## Finding 2: There Were Instances of Noncompliance with HUD Regulations

County officials did not always administer the CDBG program in accordance with HUD regulations. Specifically, they did not (1) include quantifiable performance indicators in subrecipient agreements or adequately track subrecipient performance, (2) adequately monitor subrecipients as required by HUD regulations and the County's monitoring policy, and (3) seek HUD approval or request public comment before canceling or modifying HUD-approved activities. We attribute these deficiencies to County officials' unfamiliarity with CDBG regulations and inadequate implementation of policies and procedures. In addition, procedures were not in place to impose a lien on a CDBG-assisted real property. Consequently (1) the subrecipient agreements were insufficient to provide a sound basis for the County to effectively monitor performance of subrecipients, (2) neither HUD nor County officials were assured that activities were accomplished according to program requirements, (3) neither the public nor HUD was made aware of the change in the use of more than \$400,000 for previously approved activities, and (4) neither HUD nor the County's interest was protected against future disposition of the property assisted with \$71,729 in CDBG funds,.

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### Inadequate Subrecipient Agreements

County officials executed inadequate agreements with subrecipients contrary to HUD regulations and the County's own policy. Regulations at 24 CFR 570.503(b)(1) specify that the subrecipient agreement must include a description of the work to be performed, a schedule for completing the work, and a budget. These items must be in sufficient detail to provide a sound basis for the recipient to effectively monitor performance under the agreement. However, while a 2009 monitoring review by HUD reported that the scope of services written into the County's subrecipient agreements lacked quantifiable performance indicators and the County agreed to include indicators corresponding to the nature of the activity and the national objective, 6 of the 14 subrecipient agreements reviewed lacked such information. In addition, while the County had amended its procedures to extend the time of performance for the subrecipients that were not able to complete projects within the timeframe specified in the agreements a few years earlier, County officials executed subrecipient agreements that referenced the prior procedures. Therefore, the subrecipient agreements did not provide a sound basis for the County to effectively monitor subrecipient performance as required by 24 CFR 570.503(b)(1). We attribute these deficiencies to County officials' failure to implement adequate financial and administrative controls that would provide a sound basis for monitoring subrecipients.

## **Inadequate Subrecipient Monitoring**

County officials did not monitor subrecipient performance or take action when performance was inadequate as required by HUD regulations and the County's own policy. Regulations at 24 CFR 85.40 require that grantees monitor subgrantee-supported activities to ensure compliance with applicable Federal requirements and that performance goals are achieved, and the monitoring must be over each program, function, or activity. Further, the County's policy provides detailed monitoring procedures for its specific CDBG projects, including annual reviews. However, County officials did not conduct an annual monitoring review of their social services subrecipients or perform onsite inspections of their public improvement projects. Further, they did not obtain detailed accomplishment data from 9 of 14 subrecipients to aid in evaluating subrecipient performance and failed to take action when 5 of the subrecipients did not complete their projects within the timeframe specified in the subrecipient agreements. County officials stated that they were under the impression that CDBG activities needed to be monitored only every other year. As a result, they could not assure HUD that their activities were accomplished according to program requirements. We attribute these deficiencies to County officials' unfamiliarity with HUD and County regulations.

## **Approved Projects Changed Without Proper Notification**

County officials canceled and modified their planned CDBG activities without notifying HUD and the public as required. Regulations at 24 CFR 570.302 and 91.505 and the County's policy require that HUD approval be obtained and the public be notified of any substantial amendment to the CDBG action plan. HUD allows grantees to define what would be a substantial amendment, and County officials defined it as being when a project is canceled or a new project is added. However, County officials transferred approximately \$214,000 and \$235,000 to the homeowner rehabilitation activity, which was originally allocated \$300,000 and \$77,940, in program years 2010 and 2009, thus increasing the budgets to \$514,000 and \$312,940, respectively, without notifying HUD or the public. As a result, multiple activities were either canceled or had a significant funding decrease after HUD had already approved the action plans. Therefore, more than \$400,000 in CDBG funds may not have been used for the activities previously reported to the public and approved by HUD. This deficiency existed because County officials were not familiar with HUD regulations and did not establish and enforce adequate procedures for processing program amendments.

## **Lien Not Recorded on Property Acquired With CDBG Funds**

County officials disbursed \$71,729 in CDBG funds to a nonprofit organization for the acquisition of real property to construct affordable housing without imposing a lien or a deed restriction on the property. Regulations at 24 CFR 84.37 provide that HUD may require recipients to record liens or other appropriate notices of record to indicate that the real property has been acquired with Federal funds and that use and disposition conditions apply to the property. Further, the County's housing rehabilitation policy requires that assisted property have a lien or deed restriction. This deficiency occurred because County officials believed that Regulations at 24 CFR 84.37 only suggest that a lien may be imposed. Therefore, neither HUD nor the County's interest of \$71,729 was protected against any future disposition of the property.

## **Conclusion**

County officials did not always administer the CDBG program in accordance with HUD regulations or the County's own policy. Consequently, County officials lacked assurance that their CDBG-funded activities were accomplished according to program requirements, and the public and HUD were not aware of significant amendments to the County's action plan. In addition, controls were not established to ensure that HUD's or the County's interest in real property purchased with CDBG funds was protected. We attribute these deficiencies to County officials' unfamiliarity with CDBG regulations and implementation of inadequate financial and administrative controls.

## **Recommendations**

We recommend that the Director of HUD's Newark, NJ, Office of Community Planning and Development instruct County Officials to

- 2A. Record a lien or other appropriate notice of record on the real property acquired with CDBG funds to ensure that HUD's and the County's interest in the property is adequately protected and that the \$71,729 in CDBG funds used to purchase the property would be reimbursed to the program upon disposition of the property. If a lien or other appropriate notice of record is not recorded, County officials should reimburse the County's CDBG line of credit for this amount from non-Federal funds, thus putting these funds to better use.
- 2B. Strengthen the County's internal controls to ensure that liens or other appropriate notices of record are imposed on properties acquired with CDBG funds to ensure that HUD's interest is properly protected.

- 2C. Strengthen controls to ensure that quantifiable performance measurement indicators are developed and included in all subrecipient agreements as a basis for evaluating subrecipient performance against the specific activity and applicable CDBG national objectives.
- 2D. Strengthen subrecipient monitoring procedures to provide assurance that subrecipients will comply with HUD regulations and subrecipient agreements and that appropriate action is taken when subrecipients do not comply with subrecipient agreements.
- 2E. Strengthen procedures to ensure that HUD and County residents will be properly informed of any significant amendments to the County's CDBG action plans.
- 2F. Establish the dollar amount of funds that represents a substantial change in funding and include it in the County's citizen participation plan.
- 2G. Request training on CDBG administrative requirements from the HUD Office of Community Planning and Development's field office staff.

## SCOPE AND METHODOLOGY

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The audit focused on whether County officials established and implemented adequate controls to ensure that the CDBG program was administered in accordance with program requirements. We performed the audit fieldwork from July to September 2012 at the County's offices at 30 Schuyler Place, Morristown, NJ.

To accomplish our objectives, we

- Reviewed relevant CDBG program requirements and applicable Federal regulations to gain an understanding of CDBG administration requirements.
- Interviewed staff from the HUD Newark, NJ, Office of Community Planning and Development and the County's Division of Community Development.
- Obtained an understanding of the County's management controls and procedures through analysis of its responses to management control questionnaires.
- Reviewed the County's consolidated annual performance and evaluation reports, action plans, and County Board of Chosen Freeholders' resolution of CDBG activities for program years 2010 and 2011 to gather data on the County's expenditures.
- Reviewed the County's audited financial statements for the fiscal years ending December 31, 2010 and 2011, to further our understanding of the County's programs and identify any issues for follow-up.
- Analyzed reports from HUD's computer systems, including the Integrated Disbursement and Information System,<sup>2</sup> to document County disbursements and activities. Our assessment of the reliability of the data in these systems was limited to the data sampled, which were reconciled to the County's records.
- Reviewed the County's organizational chart; citizen participation plan; and monitoring, procurement, and accounting policies.
- Reviewed 14 of 98 subrecipient agreements and the County's monitoring reports of its subrecipients during program years 2010 and 2011.
- Selected a nonstatistical sample of 15 CDBG activities with an authorized amount of more than \$1.34 million to test for compliance with HUD and County regulations and policy. This represented 30 percent of the \$4.5 million received by the County and used to fund 66 activities during program years 2010 and 2011. The sample was

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<sup>2</sup> The Integrated Disbursement and Information System is a nationwide database of current information regarding CDBG activities underway across the nation, including funding and accomplishment data. HUD uses this information to report to Congress and to monitor grantees.

designed to select a cross section of various activities based upon spending, performance status, and the nature of the activities.

The audit generally covered the period July 1, 2010, through June 30, 2012, and was extended as needed to accomplish the objectives.

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

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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.

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



## Significant Deficiencies

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

- The County did not establish or implement adequate internal controls to ensure that its program met its objectives (see findings 1 and 2).
- The County did not establish or implement adequate internal controls to ensure that resource use was consistent with laws and regulations (see findings 1 and 2).
- The County did not establish or implement adequate internal controls to ensure that resources were safeguarded against waste, loss, and misuse (see findings 1 and 2).
- The County did not establish or implement adequate internal controls to ensure that valid and reliable data were obtained, maintained, and fairly disclosed in reports (see finding 2).

## APPENDIXES

### Appendix A

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

| Recommendation<br>number | Ineligible <u>1/</u> | Unsupported<br><u>2/</u> | Unreasonable<br>or<br>unnecessary <u>3/</u> | Funds to be put<br>to better use <u>4/</u> |
|--------------------------|----------------------|--------------------------|---|--|
| 1A                       | \$19,500             |                          |   |  |
| 1C                       |                      | \$49,735                 |   |  |
| 1D                       |                      |                          |   | \$80,000                                   |
| 1E                       |                      | 80,000                   |   |  |
| 1G                       |                      |                          | \$10,970                                    |  |
| 2A                       |                      |                          |   | 71,729                                     |
|                          | \$19,500             | \$129,735                | \$10,970                                    | \$151,729                                  |


- 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/ Unreasonable or unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ 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. If the recommendation to evaluate the eligibility of the public improvement project is implemented, HUD would be assured that the \$80,000 was used for its intended purpose, and if a lien is recorded on the assisted property as recommended, HUD's \$71,729 interest would be protected, thus ensuring that funds would be available for other CDBG-eligible activities.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

|   |  |   |
|---|--|---|
| <b>COUNTY OF MORRIS</b><br><b>DEPARTMENT OF PLANNING &amp; DEVELOPMENT</b><br><b>DIVISION OF COMMUNITY DEVELOPMENT</b>  |  |   |
| Board of Chosen Freeholders<br><i>Director</i><br>Thomas J. Mastrangelo<br><i>Deputy Director</i><br>David Scapicchio<br><br>Douglas R. Cabana<br>John Cesaro<br>Ann F. Grossi<br>John Krickus<br>Hank Lyon   | P.O. Box 900<br>Morristown, New Jersey 07963-0900<br> | <i>County Administrator</i><br>John Bonanni<br><i>Director, Planning &amp; Development</i><br>Deena Leary<br><br><i>Director</i><br>Sabine von Aulock<br>973-285-6060<br>FAX 973-285-6031<br>svonaulock@co.morris.nj.us |
| <p>January 4, 2013</p> <p>Re: Draft Audit Report on Morris County, CDBG Program</p> <p>Edgar Moore, Regional Inspector General for Audit<br/>Office of Audit<br/>NY/NJ Region 2<br/>26 Federal Plaza, Room 3430<br/>NY, NY 10278-0068</p> <p>Dear Mr. Moore:</p> <p>I would like to take this opportunity to respond to the comments made in the Draft Audit Report on Morris County, CDBG Program.</p> <p><b>Recommendation 1A</b><br/>Reimburse the County's CDBG line of credit from non-Federal funds for the \$19,500 disbursed for an ineligible rehabilitation loan.</p> <p><b>Response:</b> While conducting their audit and conducting extensive research on each Rehab case, the IGA auditors found an instance in which the Rehab program provided assistance to a homeowner, who was forthright about his situation throughout his tenure in the program.</p> <ul style="list-style-type: none"><li>• Approximately 25 years ago [REDACTED] bought a house in Denville.</li><li>• Subsequently the couple separated; because they wanted to avoid attorney fees they did not divorce.</li><li>• [REDACTED] remained in Denville.</li><li>• [REDACTED] purchased a house in Montville; [REDACTED] never had title to the house.</li><li>• The house in Montville received CDBG rehab funding. The rehabbed house is currently on the market; when the sale goes through, the grant will be repaid from the proceeds.</li></ul> <p>The Division has a Reference Manual outlining policies for the Rehab program. One General Program Requirement states "The applicant cannot own any other residential properties (i.e. separate rental properties, vacation homes, etc.). The rationale behind this policy was to preclude rental income, which would likely render an applicant income ineligible.</p> |  |   |
| <small>Office located at 80 Schuyler Place • Fourth Floor • Morristown • New Jersey 07960<br/>www.morrisplanning.org</small>  |  |   |

**Comment 1**

The Division's Rehab Program brochure states that the owner can own only one house.

**Comment 1**

The application states "I certify that I am the owner and occupy the above property as my principal residence."

The applicant in question was income eligible and was truthful in his certifying that the property needing rehab work was his principal residence. The Division maintains that this was an eligible rehab loan. Nonetheless, it has revised the Homeowner Rehab program application so that the applicant's signature certifies to owning only one residential property.

**Recommendation 1B.**

Strengthen controls over the County's homeowner rehabilitation loan application procedures by revising the application to inform applicants of the prohibition against ownership of another property and include a reference to possible imposition of civil monetary penalties under the False Claims Act for anyone providing false information.

**Comment 2**

**Response:** The Division will tighten up its language and make all documents consistent. The Division will require certification to the fact that the property in question in each Rehab application is the principal residence, via signature on the application. The Community Development Revenue Sharing Advisory Committee and Board of Chosen Freeholders will be notified of any modifications to the policy.

The current application contains the warning: "Title 18, Section 1001 of the United States Code, states that a person is guilty of a felony for knowingly and willingly making false or fraudulent statements to any Department or Agency of the U.S.A. and is subject to a \$10,000 Fine." The Division will insert the language informing applicants of the possible imposition of civil monetary penalties under the False Claims Act for anyone providing false information.

Finally, the auditor admitted that this discovery of the additional property under [REDACTED]'s name was the result of unusually intense research, including the use of Lexus Nexus, not typical of due diligence conducted through the Division's normal application review.

**Comment 1**

For all these reasons, the Division suggests that the appropriate resolution to this issue is to either return \$19,500 to CDBG as a result of proceeds from the sale of the house or allow the lien to expire, 12/17/2020.

**Recommendation 1C**

Provide documentation to support that the \$49,735 drawdown was expended for eligible CDBG costs and if such support cannot be provided, repay the amount from non-Federal funds.

**Response:** A challenge in responding to the Auditor's comment is a timing issue; the housing rehabilitation program is funded each year but the expenditures of that funding can span 1-3 years.

**Comment 3**

Accounting safeguards in place include a monthly reconciliation between the Division's files, IDIS reports and Treasurer's grant reports.

Currently the Division follows the following process:

### Comment 3

- Once an application is approved, the Rehab Director conducts an onsite Property Inspection.
- The Rehab Director then prepares a Property Inspection Report, work write-up and cost estimate.
- The cost estimate is based on the scope of work and technical specifications contained in the case work write-up.
- The homeowner is required to obtain three written proposals based on the scope of work.
- Rehab Director prepares a contract between the homeowner and the contractor.
- Rehab Director acts as an administrative agent, providing technical assistance throughout the construction period.
- The construction agreement stipulates the contract price, the time of performance, the payment schedule, the holdback and final payment, procedures for termination of contract, as well as reference to the contractor's original bid specifications and warranties.
- The Rehab Director must approve any revisions to the original scope of work under contract. Change orders will be required for work that results in an increase or decrease in the contract amount.
- The Rehab Director conducts periodic inspections of work being done.
- The Rehab Director performs a final inspection to certify the property improvements are complete.
- Payment in the form of a dual party check to the Homeowner/Contractor are made, as per Construction Agreement
- 15-20% retainage is paid following municipal inspection. Safe Work Practice construction agreements require a 50% retainage until final lead-based paint hazard clearance is obtained.
- Checks are given to the homeowner for disbursement to the contractor.
- Final payment to the homeowner/contractor is made upon all local inspections and approvals.
- Work starts on payment terms.
- *Contract is equivalent to a bill; therefore payments made to contractors are reimbursements.*
- Bills are only submitted for change orders.
- Rehab Director projects money needed for a two week horizon and submits chit for Director to draw down funds from IDIS. Money is transferred to County bank in approximately 2-3 days.
- Vouchers are submitted only after contract is signed but in anticipation of work to be done.
- Check is cut shortly after voucher is submitted
- Check is delivered to homeowner who co-signs and gives to contractor

Regarding the estimated amounts used to draw down funds in anticipation of payments made to contractors, Rehab Director estimates how much he will need for a 2 week horizon but there are several unknown variables making it difficult to know the exact amount needed and for whom, including:

- Weather conditions affecting timing of work
- Status of contracts i.e. timing of the return of a signed contract
- Timing of permit approvals
- Lien recoveries and infusion of program income

The Division is working on tightening its internal controls by keeping rehab balance to a minimum and disbursing reimbursements promptly.

#### **Recommendation 1D**

Strengthen controls over reimbursement procedures to ensure that disbursement of CDBG funds, such as the \$80,000 that was disbursed for the street improvement project without adequate support, is made based upon documentation adequate to ensure that the funds were used for eligible purposes and the costs incurred were reasonable and properly supported, thus ensuring that these funds were used for their intended purpose.

**Comment 4**

**Response:** This recommendation refers to a street improvement activity, whose file lacked adequate documentation reflecting completed status of project and that associated costs were incurred for the benefit of low- and moderate-income area specified in the subrecipient agreement. As stated in report, documentation addressing these concerns was obtained, making the file complete.

Going forward recipient will assure that Grant Agreement contains detailed description of scope of work and location. Recipient will monitor vouchers, making sure that items to be reimbursed relate directly to those listed in the budget as itemized in the Grant Agreement. Documentation ensuring that funds were used for eligible purposes and the costs incurred were reasonable and properly supported, will be required.

**Recommendation 1E**

Provide documentation to support that the \$80,000 obligated for the public improvement project is an eligible expense. If it is not deemed eligible, the funds should be deobligated.

**Response:** The following describes the activity and process leading up to its funding.

Target Area: Plausha Park Service Area

Proposal: Fund extension of potable water line from the intersection of Brookwood Road and Barney Road to those residents (61 households) who are currently on the privately owned Plausha Water System.

Awarded Amount: \$80,000

Chronology:

- Autumn 2010, Township conducted survey of Plausha Park Service Area, according to Division's guidelines.
- Spring 2011, Township application to Morris County CDBG program approved for PY 2011 funding.
- November 2011, Grant Agreement executed.
- 2011-2012 Progress on activity i.e., pre-construction meeting, bid results, wage determinations.
- August, September 2012 – preliminary observations from auditors from the Inspector General's Office indicated methodology used to conduct survey was flawed; activity may be ineligible.
- September 2012 – Director requested review and determination by HUD
- October 2012 – Director reached out to HUD again; response from HUD stated their inability to make a determination until the report from the Inspector General's office was finalized.
- Division is continuing to monitor the activity on the chance that HUD's final determination is that the activity is eligible.

**Comment 5**

In determining income eligibility of a CDBG application, applicants are provided options to satisfy HUD's income requirements. An option available to municipalities for small service areas within a Census block that appears to be populated by low/mod income households is to conduct a survey. As stipulated in the grant application:

- Activity benefits a *surveyed* area (an 80% response rate is required) where at least 27.7% of the residents are L/M income.

In the case of Montville, the service area is the Plausha Water System area. The service area constitutes a very small area within the larger Census Block, necessitating the use of a survey. The data derived from the surveys are the best information available at that time.

The survey form used by the County is updated each year to reflect HUD's new income limits. The form asks for size of household and total annual household income. The recap form also reinforces the required 27.7% L/M income reflecting the County's 'Exception' status. As suggested by CPD-05-06, HUD's *Suggested Survey Methodology*, the form is short and simple, avoiding loaded questions. The survey was mailed by the municipality with a self-addressed, stamped envelope enclosed to promote response.

Sixty-one surveys were distributed with a response of 51 completed surveys. This satisfies the 95% Confidence Level at a Confidence Interval of 4, or margin of error, according to the Sample Size Calculator provided in CPD-05-06, HUD's *Suggested Survey Methodology*.

The Township was instructed as to the County's survey methodology and complied. The Division's methodology has been consistent historically and both the County and the Township were operating with full intention to comply with HUD's regulations. It was the Division's determination at the time and continues to be that the municipality followed the County's process and exceeded both thresholds, that of number of required responses and percent of low/mod income persons in the service area.

The municipality's application was recommended and approved for funding and the Township entered into Grant Agreement with the County on November 11, 2011; it has followed all the milestones required by the Division since.

The Activity is nearly complete and the Township is requesting reimbursement, as stipulated in the Grant Agreement. It is the Division's contention that all parties have acted in good faith with the understanding that they were operating within HUD's guidelines. Sixty-one surveys were distributed with a response of 51 completed surveys. This satisfies the 95% Confidence Level at a Confidence Interval of 4, or margin of error, according to the Sample Size Calculator provided in CPD-05-06. The income guidelines, as stipulated by the Division, were met by the Township.

The Division believes that the \$80,000 obligated for the public improvement project described is an eligible expense and desires to reimburse the municipality, as stipulated by the Grant Agreement. It commits to improve its internal controls by communicating with the HUD Field Office when situations arise, as to the survey vehicle used and the outcome of the survey.

**Recommendation 1F**

Strengthen the County's internal controls to ensure that the County documents support that CDBG funds will be used to assist projects in a low- and moderate-income service area in accordance with the CDBG program requirements before obligating and disbursing the funds.

**Response:** Going forward the Division will modify its survey and methodology to more closely reflect the suggested methodology described in CPD-05-06, HUD's *Suggested Survey Methodology* to Determine the Percentage of Low- and Moderate-Income (LMI) Persons in the Service Area of a Community Development Block Grant-Funded Activity. In addition, the Division will communicate directly with the HUD-Newark Field Office as to the survey vehicle used and the outcome of the survey.

**Recommendation 1G**

Provide documentation showing that the \$10,970 disbursed in excess of a subrecipient's request was reasonable and necessary. If it is deemed unreasonable or unnecessary, the funds should be repaid to the County's CDBG line of credit from non-Federal funds.

**Comment 5**

**Comment 4**

**Comment 6**

**Response:** The activity in question involved replacement of carpeting at a health facility. The entire activity cost was \$21,000, as per estimate provided by contractor. The amount requested changed from first request of \$9,030 to final request of \$20,000.

The initial ‘other sources of funding’ were stated to be “Undetermined Foundation Request(s) under development.” The non profit, however, experienced unexpected ‘tremendous expenditures’ including a \$60,000 electronic health record, which caused severe financial burden. Therefore, while they originally requested \$9,030, their scope of work and need for funding surpassed \$20,000

The costs are reasonable and necessary. The applicant made the case that the flooring in the halls and bedrooms was creating an unhealthy living environment for the residents.

Subrecipient obtained 3 quotes: 2 were at \$21,000, one was at \$22,950.

The area covered was 928.3 square yards or 33 bedrooms and hallways.

The final award of \$20,000 enabled the non profit to conduct the entire activity as planned.

The grant agreement stipulated carpeting of the female dorms and hallway, male dorms and hallway, purchase and installation of the carpeting.

Costs submitted for reimbursement targeted the items stipulated in the grant agreement. The materials and installation are eligible costs as per Circular A-87.

For all these reasons, the Division believes the subrecipient’s request was reasonable and necessary.

**Recommendation 1H**

Strengthen internal controls over the County’s financial reporting to ensure that financial information submitted to HUD is accurate, current, and complete.

**Comment 4**

**Response:** The Division has been working assiduously to assure that timeliness requirements are being satisfied, the subrecipients are completing all milestones, vouchers are being submitted and reimbursed and beneficiary data are collected for proper IDIS close-out.

**Recommendation 1I**

Request CDBG financial management training from the HUD Office of Community Planning and Development’s field office staff.

**Comment 4**

**Response:** The Division will request training from the HUD Office of Community Planning and Development’s field office staff and take advantage of any trainings made available.

**Recommendation 2A**

Record a lien or other appropriate notice of record on the real property acquired with CDBG funds to ensure that HUD’s and the County’s interest in the property is adequately protected and that the \$71,729 in CDBG funds used to purchase the property would be reimbursed to the program upon disposition of the property. If a lien is not recorded, County officials should reimburse the County’s line of credit for this amount from non-Federal funds, thus putting these funds to better use.



**Response:** 24 CFR 84.37 Property trust relationship states that HUD *may* require recipients to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with Federal funds and that use and disposition conditions apply to the property.

The Division would like to request removal of the finding of “Noncompliance” for this issue. The spirit of 84.37 has been satisfied by the Division, as allowed by the word “may.” “May” connotes a choice to act or not and “shall” makes it imperative. We would appreciate a determination from HUD if this is a suggestion or a requirement.

**Comment 7**

In this case, a subrecipient used CDBG funds to acquire land and HOME funds for construction. The HOME program requires a period of affordability of 20 years, which the Division always adheres to. In addition, because Habitat for Humanity is involved in this project, the partner families will be carrying a Habitat mortgage, which has a 30 year period of affordability. For all these reasons the Division believes that this parcel, the associated federal funds and the intended beneficiaries are well projected.

Nonetheless, as indicated in the response to Recommendation 2B, the Division has devised a lien assuring protection of the parcel and its beneficiaries. This lien has been applied to the current case and will be applied to any future comparable activities involving the investment of federal funds in real property. The aforementioned lien has already been recorded.

**Recommendation 2B**

Strengthen the County’s internal controls to ensure that liens or other appropriate notices of record are imposed on properties acquired with CDBG funds to ensure that HUD’s interest is properly protected.

**Response:** To satisfy the concerns of the auditors and to improve internal controls, the Division has devised a legal instrument, a lien, assuring protection of the parcel and its beneficiaries. This lien has been applied to the current case and will be applied to any future comparable activities involving the investment of federal funds in real property. The aforementioned lien has already been recorded.

**Comment 4**

**Recommendation 2C**

Strengthen controls to ensure that quantifiable performance measurement indicators are developed and included in all subrecipient agreements as a basis for evaluating subrecipient performance against the specific activity and applicable CDBG national objectives.

**Response:** The Division commits to creating connectivity between applicant documents i.e. directly tying the information provided in the application, which includes CDBG national objectives and quantifiable performance measurement indicators, with the grant agreement.

**Comment 4**

**Recommendation 2D**

Strengthen subrecipient monitoring procedures to provide assurance that subrecipients will comply with HUD regulations and subrecipient agreements and that appropriate action is taken when subrecipients do not comply with subrecipients’ agreements.

**Comment 4**

**Response:** The Division has already begun implementing this recommendation. It has made its monitoring policy more explicit in terms of frequency and content of monitoring. The Division has also obtained approval from the Community Development Revenue Sharing Advisory Committee to assume responsibility for reviewing and granting requests for extensions, as part of the grant management process.

In addition, the Division has historically required household information i.e. female head of household, number of members, income, etc. in the back-up documentation attached to vouchers submitted for reimbursement by Services subrecipients. These data provide the Division the opportunity to desk monitor providers, assuring income guidelines are being met.

**Recommendation 2E**

Strengthen procedures to ensure that HUD and County residents will be properly informed of any significant amendments to the County's CDBG action plans.

**Comment 4**

**Response:** The Division will abide by its Citizen Participation Plan, which stipulates notification protocol for amendments and substantial amendments to the action plans.

**Recommendation 2F**

Establish the dollar amount of funds that represents a substantial change in funding and include it in the County's Citizen Participation Plan.

**Comment 4**

**Response:** The Division will develop policy establishing \$20,000 reprogrammed funds as the threshold amount triggering an amendment to the annual Action Plan. The suggested policy will be presented to the Community Development Revenue Sharing Advisory Committee and incorporated it into the Citizen Participation Plan if approved.

**Recommendation 2G**

Request training on CDBG administrative requirements from the HUD Office of Community Planning and Development's field office staff.

**Comment 4**

**Response:** The Division will request training from the HUD Office of Community Planning and Development's field office staff and take advantage of any trainings made available.

To conclude we would like to express our appreciation for your consideration. We look forward to resolving these issues with the end result being an improved program.

Sincerely,



Sabine von Aulock  
Director

## OIG Evaluation of Auditee Comments

- Comment 1** County officials acknowledged that the \$19,500 rehabilitation loan was provided to a homeowner who owned a second residence, which the County's rehabilitation program policy prohibited. However, County officials maintain that the loan was eligible since the owner was income eligible and the assistance was provided for his primary residence as required by the program regulations. Nevertheless, County officials stated that the residence for which the loan was provided is for sale, and they propose to either recoup the \$19,500 for the CDBG program from the sale proceeds or allow the lien to expire on 12/17/2020. This issue will be addressed during the audit resolution process with HUD officials.
- Comment 2** OIG acknowledges that it may not be feasible for the County to identify all potential applicant misrepresentations, and as such has recommended that applicants be informed of possible imposition of civil monetary penalties under the False Claims Act for falsification of applicant information. County officials agreed to revise their current rehabilitation application form to disclose this possible liability to applicants, thus putting the onus on potential applicants. County officials' comments are responsive to our recommendation.
- Comment 3** County officials stated that reconciliation of the Division's files, IDIS reports and the Treasurer's grant reports is one of the accounting safeguards in place, and described their current rehabilitation program drawdown and disbursement procedures. County officials did agree to tighten their internal controls to keep rehabilitation program cash balances to a minimum and disburse reimbursements promptly. However, County officials did not provide documentation to address the \$49,735 found to have been drawdown based upon estimated as opposed to actual costs, and thus regarded as an unsupported expense. This issue will be addressed during the audit resolution process with HUD officials.
- Comment 4** County officials described planned corrective actions which are responsive to our recommendation.
- Comment 5** County officials maintain that the \$80,000 obligation for a public improvement project is an eligible CDBG program expense. While the nature of the obligation is an eligible CDBG program expense, County officials did not comply with HUD procedures prescribed in 24 CFR 570.208 that require any surveys to meet the statistical reliability of the decennial census and be approved by HUD. This issue will be addressed during the audit resolution process with HUD officials. County officials agreed to improve its internal controls by communicating with HUD field office in the future as to the survey vehicle used and outcome of the survey.
- Comment 6** County officials explained that the subrecipient had experienced financial hardship and therefore the \$10,970 disbursed in excess of the subrecipient's initial request was reasonable and necessary. However, County officials could not locate any additional documentation to support their explanation. County

officials are attempting to obtain such documentation from the subrecipient; therefore, this issue will be resolved during the audit resolution process with HUD.

**Comment 7** We acknowledge that HUD regulations at 24 CFR 84.37 use the word “may”, which allows grantees the option to record a lien or other appropriate notice of record to indicate that personal or real property has been acquired or improved with federal funds and that use and disposition conditions apply to the property; therefore, we have revised the report to not cite this as an instance of noncompliance, but as a need to strengthen controls to better protect HUD’s interest. Since grantees have a fiduciary responsibility to safeguard federal funds and ensure that HUD’s interest is properly protected, we believe that an appropriate notice of record should have been executed, as is done for the County’s housing rehabilitation program. Further, County officials stated that they have taken action to record a lien as suggested.