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Audit Report Number 2007-NY-1008

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

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

SUBJECT: The City of Newark Did Not Always Administer Its Community Development Block Grant Program in Accordance with HUD Requirements

HIGHLIGHTS

What We Audited and Why

We audited the City of Newark's (City) Community Development Block Grant (CDBG) program. We selected the City for review because of the size of its program and because the U.S. Department of Housing and Urban Development (HUD) classified it as a high-risk CDBG recipient in a 2005 annual assessment. Our audit objectives were to determine whether the City (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to HUD and with applicable rules and regulations, (2) had a financial management system in place to adequately safeguard the funds, and (3) had program controls in place to ensure that activities were administered properly and met the CDBG national objectives.

What We Found

The City did not always comply with applicable regulations and its submission to HUD while disbursing CDBG funds. Specifically, it did not (1) maintain proper supporting documents for payments made on a bond obligation, (2) report and adequately account for program income, and (3) maintain adequate supporting documents for its drawdowns. As a result, more than \$10 million in bond and other payments is unsupported, \$261,228 in disbursements is ineligible, and the City cannot ensure that more than \$9.7 million in future bond payments will be an efficient use of funds.

There were control weaknesses in the City's financial management system used to safeguard funds. Specifically, the City's financial management system did not ensure that (1) administrative costs were expended in proportion to delivery costs, (2) adequate time distribution records were used to allocate personnel expenses to various programs, (3) accounting records were accurate, and (4) key positions had adequate separation of duties. Consequently, funds allotted for administration may have been expended prematurely, CDBG funds may have been used to pay the salaries of employees not participating in CDBG activities, financial information may not have been accurate, and funds were not properly safeguarded.

The City did not implement proper program controls in accordance with HUD requirements. Specifically, it did not adequately monitor its CDBG programs administered by its subgrantees and itself, or properly document whether programs met the CDBG national objectives and were accomplished in compliance with federal laws and contractual standards.

What We Recommend

We recommend that the director of HUD's New Jersey Office of Community Planning and Development instruct the City to (1) reimburse the CDBG program from nonfederal funds the \$246,523 paid in excessive bond drawdowns, (2) provide supporting documentation for more than \$9.8 million in disbursements made related to bond payments or reimburse the CDBG program for any amounts not supported from nonfederal funds, (3) establish procedures to ensure that adequate documentation for all future bond payments is maintained, (4) determine the actual amount of unreported program income and provide support for the disposition of these funds or reimburse that amount to the CDBG program, (5) provide supporting documentation for the unsupported drawdowns and reimburse all overdrawn amounts, and (6) establish and implement adequate control procedures to ensure the proper administration of all CDBG activities.

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

On May 8, 2007, we requested the auditee to provide their response. We discussed the results of our review during the audit and at an exit conference on May 22, 2007, when the auditee provided their written response. The auditee disagreed with portions of the report. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

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

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

The City of Newark (City) is a CDBG entitlement recipient that has administered more than \$10 million in CDBG funds annually during the past 10 years. These funds are available to support a variety of activities directed at improving the physical condition of neighborhoods by providing housing or public improvements/facilities, creating employment, or improving services for low- and/or moderate-income households. Generally, City funds are used to pay the invoices submitted by organizations carrying out CDBG activities, and the City receives reimbursement from the U.S. Department of Housing and Urban Development (HUD) by submitting drawdown requests to the U.S. Treasury.

The City works with about 100 nonprofit organizations to carry out its CDBG-funded programs. Various departments and divisions of the City are responsible for overseeing, monitoring, and supporting its many CDBG activities. The City's files and records related to its CDBG programs are maintained at 920 Broad Street, 110 William Street, 828 Broad Street, and 295 Halsey Street, Newark, New Jersey.

We audited the City's CDBG program because of the size of its program and because HUD classified it as a high-risk recipient in its 2005 annual community assessment. Our audit objectives were to determine whether the City (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to HUD and with applicable rules and regulations, (2) had a financial management system in place to adequately safeguard the funds, and (3) had program controls in place to ensure that activities were administered properly and met the CDBG national objectives.

RESULTS OF AUDIT

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

The City did not always comply with applicable regulations and its submission to HUD while disbursing CDBG funds. Specifically, the City did not (1) maintain proper supporting documents for payments made on a bond obligation, (2) report and adequately account for program income, and (3) maintain adequate supporting documents for its drawdowns. This noncompliance occurred because of the City's inadequate controls over bond financing activities, accounting for program income, and support for drawdowns from HUD. As a result, more than \$10.1 million in bond and other payments is unsupported, \$261,228 in disbursements is ineligible, approximately \$1 million in program income was not reported to HUD or adequately supported, and the City cannot ensure that more than \$9.7 million in future bond payments will be an efficient use of funds.

Unsupported/Ineligible Bond Obligation Payments

The Essex County Improvement Authority (ECIA) issued bonds in 1994 on behalf of the City for a principal of \$11.17 million to fund seven redevelopment projects, and the City's repayment for the debt to ECIA started in 1995. In 1999, the City refinanced part of the debt at lower interest rates for a principal amount of approximately \$8.23 million, which would be paid off in 2014. The remaining principal of \$2.77 million retained its amortization with the original interest rates and was paid off in 2005. However, the City did not maintain proper supporting documents for payments made on this bond obligation. Specifically, the City did not (a) maintain records that provided a full description of what the bond was for; the amount of funds budgeted, obligated, and expended; and the accomplishments of the bond activities; (b) maintain adequate support for the payments made or how bond proceeds were allocated to the seven activities; (c) maintain proper documentation to support that disbursements met one of the three national objectives; and (d) inform HUD that two of seven activities related to the bonds were abandoned and/or replaced.

Regulations at 24 CFR [*Code of Federal Regulations*] 85.42, 570.506, and 570.502 provide that the grantee should maintain proper supporting documentation for at least four years after the last expenditure report is submitted, in which the activity is reported as complete. The New Jersey State Record Retention regulation requires that bond files be maintained for seven years from the bond cancellation or maturity date. However, as stated above, the City did not maintain proper supporting documents for payments made on this bond obligation. We attribute these deficiencies to a lack of adequate financial and program controls over bond financing activities.

Consequently, because of the inadequate documentation, more than \$9.83 million in bond payments made by the City is considered unsupported pending an eligibility determination by HUD. Further, the amortization table established in 1999 for this bond indicates that more than \$9.76 million in additional bond payments has to be made through the year 2014. However, without adequate support for these payments, the City cannot ensure that the payments will be an efficient use of funds. Consequently, procedures are needed to ensure that the payments are adequately documented and meet the CDBG national objectives, thus ensuring that the funds are put to better use.

In addition, the City made excessive drawdowns related to bond payments after 1999 since it did not follow the refinanced bond debt repayment schedule. Instead, it drew down CDBG funds for bond payments according to the original schedule, which had a higher interest rate than the refinanced one. As a result, \$246,523 in excessive drawdowns was made from HUD. Since the actual bond payment was a lower amount, the City should have explained what the additional funds were used for. However, supporting documents for the excess drawdowns were not maintained; therefore, this amount is ineligible and should be reimbursed to the CDBG program.

Unreported Program Income

The City did not report program income to HUD and did not have adequate controls over the accounting for program income. Regulations at 24 CFR 570.504 require that receipts and expenditures of program income 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. The City drew down CDBG funds from HUD for demolition activities and was later reimbursed by property owners, who paid the costs of the demolition and other charges including interest and penalties for late payments. The City officials stated that since 1999, the CDBG programs have received approximately \$1 million (the City is still calculating the actual amount as of the date of this report) in program income generated by its demolition services. However, it did not report the program income to HUD or keep proper records of how the funds were disbursed.

According to City officials, this problem had been known for a long time and remained unresolved due to a lack of communication among the City's various departments and the decentralized structure of the City's CDBG administration. As a result, HUD has no assurance that program income was used for CDBG activities that complied with program requirements or whether the City drew down CDBG funds when program costs should have been applied to program income. Consequently, the City must determine the total amount of unreported program income since 1999 and provide documentation to show whether the program income was used for eligible activities. The City also needs to establish procedures to ensure that program income is properly accounted for and accurately reported to HUD.

Drawdowns Not Adequately Supported or Ineligible

The City did not always have adequate supporting documentation for its CDBG drawdowns. As a result, we could not determine whether costs charged to the program were for eligible purposes and/or were reasonable. This deficiency was the result of the City's inadequate controls over drawdowns and disbursements. Regulations at 24 CFR 570.506 indicate that the grantee shall maintain evidence to support how CDBG funds provided to such entities are expended. This was not always done by the City as shown in the following examples:

- The City's Division of Housing Assistance submitted drawdown requests for various rehabilitation activities; however, the City's files did not contain sufficient supporting documents for the payments. Missing documentation included independent architect provided work plans, inspectors' certificates of completion, and cost or price analyses for the projects. The amount of unsupported drawdowns for the projects administered by the Division of Housing Assistance was \$189,956.
- Certain drawdowns for building inspection projects were based on estimates and did not reconcile with the supporting documents. Since the adjustment records only showed a lump-sum amount without a detailed breakdown of the information, we were unable to determine whether the City made adequate adjustments for the estimates. The amount of unsupported drawdowns for these building inspection projects was \$83,877.
- Records of overtime payments totaling \$59,006 for employees at the Department of Health and Human Services lacked information supporting that overtime was incurred for CDBG-funded activities. In addition, \$1,236 was ineligible since the payment was paid to an employee who did not perform any CDBG services.
- The Division of Demolition and Clearance overdrew \$13,469 from CDBG funds without proof of actual expenses. Therefore, these excess funds are ineligible.

As a result of not maintaining adequate supporting documentation for its drawdowns, the total unsupported drawdowns amount to \$332,839, and total ineligible costs amount to \$14,705.

Conclusions

The City did not always comply with applicable regulations and its submission to HUD while disbursing CDBG funds. Consequently, more than \$10.1 million in disbursements related to bonds and other items is not supported, and \$261,228 in disbursements is ineligible; \$9.7 million in future payments on a bond issue remains

questionable; and about \$1 million in program income was not reported to HUD or adequately supported. We attribute these deficiencies to a lack of adequate financial and program controls over CDBG activities.

Recommendations

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

- 1A. Reimburse the CDBG program from nonfederal funds the \$246,523 in excessive drawdowns related to bond debt repayments.
- 1B. Provide supporting documentation to HUD showing that the \$9.83 million in disbursements for bond principal and interest is eligible and in compliance with HUD regulations. Any amounts determined to be ineligible must be reimbursed to the CDBG program from nonfederal funds.
- 1C. Establish and implement procedures to ensure that adequate documentation for all future bond payments is maintained and is an eligible expense of the program or discontinue making these payments. This would ensure that at least one year of future bond payments that amount to \$991,171 would be a cost savings, and these funds would be put to better use.
- 1D. Determine the actual amount of unreported program income earned since 1999, which should include the interest and penalty payments received by the City. Then submit all supporting documents showing the eligibility and propriety of the program income that was earned and disbursed during the period. Any amounts determined to be ineligible must be reimbursed to the CDBG program from nonfederal funds.
- 1E. Provide all supporting documentation showing that \$332,839 in unsupported drawdowns related to rehabilitation projects, building inspections, and employee overtime is eligible and in compliance with HUD regulations. Any amounts determined to be ineligible must be reimbursed to the CDBG program from nonfederal funds.
- 1F. Reimburse the CDBG program from nonfederal funds the \$14,705 in excessive drawdowns related to demolition services and the salary paid to the employee who did not conduct CDBG activities.

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

The City had weaknesses in its financial management system. It did not always comply with HUD requirements to ensure that (1) administrative costs were reasonably expended in proportion to delivery costs, (2) adequate time distribution records were used to allocate personnel expenses to various programs, (3) accounting records were accurate, and (4) key positions had adequate separation of duties. This noncompliance occurred because the City did not develop and implement adequate procedures to ensure compliance with all HUD regulations. Consequently, funds allotted for administration may have been expended prematurely, CDBG funds may have been used to pay the salaries of employees not participating in CDBG activities, financial information may not have been accurate, and funds were not properly safeguarded as there was a lack of assurance that funds were being used for eligible purposes.

Excessive Administrative Costs Possible

Excessive administrative costs may have been charged to the City's CDBG program. Regulations at 24 CFR 570.206 provide for the payment of reasonable administrative costs related to the planning and execution of community development activities. The City expended more than \$1.77 million or 88 percent of its total budget for administrative costs during program year 2005, while delivery costs represented only 46 percent of the total budget for program delivery of \$8.08 million. Prudent business practices dictate that funds to administer an activity should be expended in proportion to expenses for the actual activity or program delivery. However, the City seems to be swiftly expending its administrative funds. This appears to be the result of having inadequate controls over costs charged to program administration. As a result, funds to pay for proper administration of the program may not be sufficient for later periods.

Lack of Adequate Time Distribution Records

The City did not have adequate time distribution records to account for the salaries being charged to the CDBG program. Therefore, salaries charged to the program may have been excessive. According to Office of Management and Budget Circular A-87, employees should be compensated for the time devoted to an activity and be identified specifically to the performance of those activities. The City did not track its employees' time by program activities. It charged to the CDBG program the full salary of many employees who performed additional functions not related to CDBG activities. For instance, two managers in the Division of Demolition and Clearance provided oversight to both CDBG- and

non-CDBG-funded projects, but their salaries were completely paid from CDBG funds. As a result, personnel costs were not accurately charged to various programs; thus, CDBG funds could have been used to compensate employees who worked on non-CDBG-related activities and may have been ineligible.

Inaccurate Accounting Records

The City's accounting records were not accurate, current, or complete. Office of Management and Budget Circular A-87, section C, entitled "Basic Guidelines," paragraph 1(j), requires that costs be adequately documented to be allowable under federal awards. City funds were used to pay for the expenses incurred by CDBG activities, and the City was later reimbursed from CDBG funds. To track the expenses, the City maintained its own accounting data in its PeopleSoft accounting system and kept its CDBG drawdown records in HUD's Integrated Disbursement and Information System. However, the City did not perform timely reconciliations between the two systems.

For example, the Department of Neighborhood and Recreational Services had to draw down funds from HUD to pay salaries for the employees who worked on the building inspection projects. However, the information entered into HUD's system was based on estimates due to delays in obtaining financial data such as employees' timesheets from the PeopleSoft system. Nevertheless, the department did not make timely adjustments to HUD's system to record accurate information until the end of the program year. As a result, identified accounting errors related to payroll estimates were not corrected in a timely manner and may have affected the overall accuracy of CDBG fund administration. The delayed reconciliation between the two systems was also noted for other departments and divisions including the Department of Health and Human Services. Moreover, the financial reports in the consolidated annual performance and evaluation report did not reconcile with each other. Therefore, the City cannot adequately ensure HUD and its citizens that its financial information is accurate, current, or complete.

Inadequate Separation of Duties for Bond Payments

There was inadequate separation of duties in processing Essex County Improvement Authority (ECIA) bond debt repayments. Regulations at 24 CFR 570.489(d) provide that a grantee must have adequate controls to ensure that all funds received are used in compliance with all applicable statutory and regulatory provisions. Adequate controls would include having key duties and responsibilities in authorizing, processing, recording, and reviewing transactions separated among different individuals. Managers should exercise appropriate oversight to ensure that individuals do not exceed or abuse their assigned

authorities. However, the assistant treasurer of the City was the only person handling the ECIA bond debt repayments, including issuing the payments, authorizing the payments, sending out the payments, and keeping the records for the payments. No other staff members were responsible for reviewing or supervising his work. As a result, CDBG funds were not properly safeguarded, and the City cannot ensure that payments were properly authorized, processed, and recorded.

Conclusions

The City incurred excessive administrative costs, lacked adequate time distribution records to track employees' time spent on CDBG activities, did not maintain accurate accounting and financial information, and did not properly separate duties in processing ECIA bond debt repayments. Based on these deficiencies, we concluded that there were control weaknesses in the City's financial management system.

Recommendations

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

- 2A. Establish controls to ensure that administrative funds are expended in proportion to program delivery costs to ensure that administrative funds are available throughout the program delivery period without exceeding the budget.
- 2B. Develop and implement time distribution records to track its employees' time spent on various programs and ensure that salary costs charged to the CDBG programs are reasonable and properly supported.
- 2C. Establish an appropriate financial management system to ensure that all financial data are accurate, current, and complete and that timely adjustments are made when errors are recognized.
- 2D. Implement adequate internal controls to ensure that key positions and duties are properly segregated among individuals and that managers provide appropriate supervision.

Finding 3: The City Did Not Have Adequate Program Controls

The City did not implement proper program controls in accordance with HUD requirements. It did not adequately monitor its CDBG programs administered by its subgrantees and itself or properly document whether the programs were CDBG eligible, met one of the CDBG national objectives, and were accomplished in compliance with federal laws and contractual standards. This noncompliance occurred because the City did not develop and implement adequate control procedures to ensure compliance with all HUD regulations. As a result, it may lack procedures to detect deficiencies in carrying out CDBG activities and take necessary actions to correct or prevent potential problems.

Projects Not Adequately Monitored

Regulations at 24 CFR 570.501(b) provide that the recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. Subpart J of 24 CFR Part 85 states that grantees must monitor subgrantee activities to assure compliance with applicable federal requirements and that performance goals are being achieved. The City did not perform fiscal and/or programmatic reviews of its subgrantees and/or in-house projects for several years. For instance, the Division of Housing Assistance has not performed any fiscal or programmatic monitoring of its subgrantees since 2000. The Department of Health and Human Services has only conducted programmatic monitoring of its subgrantees since 1999 when the fiscal monitoring duty was taken over by the City's internal auditors. Further, the internal auditor last performed fiscal monitoring in January 2002. In addition, several in-house projects administered by the Department of Health and Human Services were not properly monitored because the monitors were not able to obtain the necessary cooperation from individuals who were in charge of projects such as the Pediatric Van Project. Without adequate monitoring, there is no assurance that activities are being accomplished according to program requirements and that financial information is accurate and properly supported.

Eligibility Not Evident

The City did not maintain documentation to support whether CDBG activities were eligible and met the national objectives. Two of the seven redevelopment projects funded by Essex County Improvement Authority (ECIA) bond proceeds (see finding 1) were either canceled or replaced with another project. However, the City did not provide adequate documentation to explain why the project was canceled, how much CDBG funding was disbursed before the cancellation, or what the City planned for the remaining budget. Therefore, adequate information was not furnished by the City to provide a reason for changing the use of the real property or justify the eligibility of the replacement project as stated in 24 CFR

570.489(j). Moreover, the City did not inform HUD and its citizens of these changes as required by HUD regulations and its own policies. We attribute these deficiencies to a lack of controls to ensure that activities meet program eligibility requirements.

This deficiency was also evidenced in many projects administered by the City's Division of Housing Assistance as documentation supporting that the work was completed and met program objectives and standards was not available. One example is the rehabilitation projects discussed in finding 1, for which the City did not provide the documentation to support the eligibility of the activity. Consequently, by not maintaining the appropriate evidence in its files, the City could not demonstrate that some activities met at least one of the three CDBG national objectives as required by 24 CFR 570.200(a).

Conclusions

The City did not adequately monitor its CDBG projects, maintain proper documentation to support whether these CDBG activities met the national objectives, and determine whether the activities were completed in compliance with requirements. Therefore, the City did not have adequate program controls over its CDBG activities.

Recommendations

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

- 3A. Develop and implement an adequate project monitoring system to ensure that projects comply with HUD regulations and the objectives of the program. The City should resume both fiscal and programmatic monitoring reviews of all of the projects carried out by City agencies and/or subgrantees.
- 3B. Establish and implement policies and procedures to ensure that all funded activities meet at least one of the three CDBG national objectives. Procedures should also require that documentation supporting the eligibility of projects be maintained in City files and any cancellations or changes to the nature of the projects or national objectives should be disclosed to the HUD Office of Community Planning and Development field office and the citizens of the City.

SCOPE AND METHODOLOGY

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

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

The City's Consolidated Annual Performance and Evaluation Report (CAPER) reflects that \$7.9 million in CDBG funds was disbursements for 83 projects or activities between May 1, 2005 and April 30, 2006. The projects consisted of two groups, those administered by the City or by its subgrantees. We selected five projects with the highest disbursement amounts for each group, resulting in a sample of ten projects totaling \$3.97 million. We reviewed the expenditures and related supporting documents for the test projects to determine whether the expenditures met CDBG requirements, were reasonable, and complied with national objectives. We also evaluated whether general administrative costs were reasonable and in proportion to delivery costs. In addition, we examined whether program income was recorded during our audit period. We also examined the City's internal controls over its administration of the CDBG program.

In relation to the City's payments made on a bond obligation (finding 1), we computed funds to be put to better use by reviewing the current bond amortization schedule, which went into effect after the 1999 refinancing. The last drawdown from HUD was for the April 1, 2004, bond payment and was drawn down on February 28, 2006. From the amortization schedule, we determined that the total future bond payments would amount to \$9,767,481, which covers the payments from April 1, 2005, through April 1, 2014. To be conservative, we estimated that one year of future bond payments, which amounts to \$991,171 would represent a cost savings or funds to be put to better use if the City strengthens its controls. Specifically, if the City implements our recommendations to establish and implement procedures to ensure that adequate supporting documentation for all future bond payments and support for the eligibility of the

payments is maintained, it will be able to ensure HUD and its citizens that the use of CDBG funds to make these payments is an efficient use of funds. As a result, these funds will be used more efficiently and will meet program requirements.

The audit generally covered the period from May 1, 2005, through April 30, 2006. We extended the period as needed to accomplish our objectives. Due to the nature of some of the deficiencies, we extended the period back to 1994.

We performed our audit fieldwork from September 2006 through April 2007 at the City's offices in Newark, New Jersey. We conducted our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- The City did not have adequate controls over compliance with laws and regulations, as it did not always comply with HUD regulations while disbursing CDBG funds (see finding 1).
- The City did not adequately safeguard resources when it did not properly account for program income, prudently disburse administrative funds, develop time distribution records, maintain accurate accounting records, or segregate duties (see findings 1 and 2).
- The City did not have adequate controls over its program operations when it did not adequately monitor its CDBG programs administered by subgrantees and document whether activities met CDBG requirements (see finding 3).

APPENDIXES

Appendix A

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

<u>Recommendation number</u>	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	<u>Funds to be put to better use 3/</u>
1A	\$246,523		
1B		\$9,831,537	
1C			\$991,171
1E		332,839	
1F	14,705		
Total	\$261,228	\$10,164,376	\$991,171

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.

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

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures, and any other savings which are specifically identified. In this instance, if the City implements our recommendation to establish and implement procedures that will ensure that adequate supporting documentation and support for the eligibility of all future bond payments is maintained, it will be able to ensure HUD and its citizens that the use of CDBG funds to make these payments is an efficient use of funds. The above amount represents one year of future bond payments.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

DRAFT AUDIT REPORT ON:
CITY OF NEWARK Community Development
Block Grant Program

DRAFT REPLY BY
THE CITY OF NEWARK

May 22, 2007

Comment 1

Introduction

We in the new Newark city administration appreciate the thoroughness and professionalism of the HUD OIG staff that audited our CDBG program last fall. Our initial efforts at evaluating city operations, diagnosing problems and prescribing solutions have led us to some of the same general conclusions as those of the audit team. Rest assured that we take your findings and recommendations quite seriously and appreciate the constructive spirit in which you have conveyed them to us. Nevertheless, we wish to point out some instances in which we respectfully disagree with or have a need for clarification of your findings, and other instances in which, upon further discussion and research, we now have information that should resolve issues you raise.

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

The City did not always comply with applicable regulations and its submission to HUD while disbursing CDBG funds. Specifically, the City did not (1) maintain proper supporting documents for payments made on a bond obligation, (2) report and adequately account for program income, and (3) maintain adequate supporting documents for its drawdowns. This noncompliance occurred because of the City's inadequate controls over bond financing activities, accounting for program income, and support for drawdowns from HUD. As a result, more than \$10.1 million in bond and other payments is unsupported, \$261,228 in disbursements is ineligible, approximately \$1 million in program income was not reported to HUD or adequately supported, and the City cannot ensure that more than \$9.7 million in future bond payments will be an efficient use of funds.

Unsupported/Ineligible Bond Obligation Payments

The Essex County Improvement Authority (ECIA) issued bonds in 1994 on behalf of the City for a principal of \$ 11.17 million to fund seven redevelopment projects, and the City's repayment for the debt to ECIA started in 1995. In 1999, the City refinanced part of the debt at lower interest rates for a principal amount of approximately \$8.23 million, which would be paid off in 2014. The remaining principal of \$2.77 million retained its amortization with the original interest rates and was paid off in 2005. However, the City did not maintain proper supporting documents for payments made on this bond obligation. Specifically, the City did not (a) maintain records that provided a full description of what the bond was for; the amount of funds budgeted, obligated, and expended; and the accomplishments of the bond activities; (b) maintain adequate support for the payments made or how bond proceeds were allocated to the seven activities; (c) maintain proper documentation to support that disbursements met one of the three national objectives; and (d) inform HUD that two of seven activities related to the bonds were abandoned and/or replaced.

Regulations at 24 CFR [Code of Federal Regulations] 85.42, 570.506, and 570.502 provide that the grantee should maintain proper supporting documentation for at least four years after the last expenditure report is submitted, in which the activity is reported as complete. The New Jersey State Record Retention regulation requires that bond files be maintained for seven years from the bond cancellation or maturity date. However, as stated above, the City did not maintain proper supporting documents for payments made on this bond obligation. We attribute these deficiencies to a lack of adequate financial and program controls over bond financing activities.

Consequently, because of the inadequate documentation, more than \$9.83 million in bond payment made by the City is considered unsupported pending an eligibility determination by HUD. Further, the amortization table established in 1999 for this bond indicates that more than \$9.76 million in additional bond payments has to be made through the year 2014. However, without adequate support for these payments, the City cannot ensure that the payments will be an efficient use of funds. Consequently, procedures are needed to ensure that the payments are adequately documented and meet the CDBG national objectives, thus ensuring that the funds are put to better use.

Response

When we first considered using CDBG funds to repay the bonds, we reached out to HUD/CPD for an eligibility/national objectives determination. HUD staff declined to offer even an advisory opinion. We then made our best, most careful determination, placed all documentation in our files, and kept HUD advised at all times of our actions and rationales. In 2001, HUD verbally requested further information. (We provided the OIG with our written reply.) We never heard back from HUD, which is a commonly accepted "yes". Since that time, HUD/CPD has monitored our programmatic and fiscal records for the bond activity on several occasions during its annual visits and never offered any written comments.

Over the past 3-4 years, we have considered the repayments to be a "settled issue". We now realize that we have not been as diligent in maintaining the original records, as the law requires. But we most certainly exercised due diligence and took very assertive measures with our HUD/CPD office to comply, to the best of our understanding, with eligibility, national objectives, environmental and financial management rules and regulations.

Attached as Exhibit A, for OIG review and inclusion as part of our reply to the audit findings, are records of the eligibility/national objectives categories for the individual activities that are the basis for the bonds. These are from Newark's FY 1995 HUD Consolidated Plan. We are additionally attaching the summary forms from our environmental review records of the activities, all of which were determined to be exempt from the requirements of the 1969 National Environmental Policy Act.

Comment 2

Comment 3

In addition, the City made excessive drawdowns related to bond payments after 1999 since it did not follow the refinanced bond debt repayment schedule. Instead, it drew down CDBG funds for bond payments according to the original schedule, which had a higher interest rate than the refinanced one. As a result, \$246,523 in excessive drawdowns was made from HUD. Since the actual bond payment was a lower amount, the City should have explained what the additional funds were used for. However, supporting documents for the excess drawdowns were not maintained; therefore, this amount is ineligible and should be reimbursed to the CDBG program.

Response

Unreported Program Income

The City did not report program income to HUD and did not have adequate controls over the accounting for program income. Regulations at 24 CFR 570.504 require that receipts and expenditures of program income 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. The City drew down CDBG funds from HUD for demolition activities and was later reimbursed by property owners, who paid the costs of the demolition and other charges including interest and penalties for late payments. The City officials stated that since 1999, the CDBG programs have received approximately \$1 million (the City is still calculating the actual amount as of the date of this report) in program income generated by its demolition services. However, it did not report the program income to HUD or keep proper records of how the funds were disbursed.

According to City officials, this problem had been known for a long time and remained unresolved due to a lack of communication among the City's various departments and the decentralized structure of the City's CDBG administration. As a result, HUD has no assurance that program income was used for CDBG activities that complied with program requirements or whether the City drew down CDBG funds when program costs should have been applied to program income. Consequently, the City must determine the total amount of unreported program income since 1999 and provide documentation to show whether the program income was used for eligible activities. The City also needs to establish procedures to ensure that program income is properly accounted for and accurately reported to HUD.

Response

We agree with this finding, which our staff frankly discussed with the OIG auditors. We have conveyed to our managers the unacceptability of the situation with program income, and have received pledges that it will be resolved by mid-June. Our senior management and directors are monitoring progress and accept full responsibility for reporting PI both by direct communication with our HUD/CPD office and through IDIS entries.

Comment 4

Comment 5

Drawdowns Not Adequately Supported or Ineligible

The City did not always have adequate supporting documentation for its CDBG drawdowns. As a result, we could not determine whether costs charged to the program were for eligible purposes and/or were reasonable. This deficiency was the result of the City's inadequate controls over drawdowns and disbursements. Regulations at 24 CFR 570.506 indicate that the grantee shall maintain evidence to support how CDBG funds provided to such entities are expended. This was not always done by the City as shown in the following examples:

- The City's Division of Housing Assistance submitted drawdown requests for various rehabilitation activities; however, the City's files did not contain sufficient supporting documents for the payments. Missing documentation included independent architect provided work plans, inspectors' certificates of completion, and cost or price analyses for the projects. The amount of unsupported drawdowns for the projects administered by the Division of Housing Assistance was \$189,956.

Response

Division of Housing Assistance (DHA) files contained information required to document payments. When necessary an architect will develop construction drawings, bid specifications, specific products, etc., but independent architect work plans are not developed unless the nonprofit requests them and, for most community based organization (CBO) rehabilitation projects, architect work plans are not needed because contractors perform work based on a set of construction drawings.

DHA technical employees are trained to monitor construction work and prepare cost estimates/work write-ups to determine the projected cost to complete an activity. The work is then publicly bid and contractors submit their proposals (prices) to the CBO. Generally, the DHA accepts a contractor's prices that are within the variance of 10% above or 10% below the DHA's estimate. Should a price fall outside of the DHA price range, the contractor's proposal is analyzed in detail to determine why his/her price exceeds the DHA's estimate. If the variance cannot be justified, the proposal is rejected. In instances where the contractor's price is justified, the DHA uses the contractor's prices to establish a schedule of values and disburse payments.

The Cost Estimate/Work Write-Up is used to determine the progress of work, percentage of work completed by a contractor and the amount of funds that should be paid when stage payments are disbursed to a contractor. Since a DHA technical employee monitors each project's construction activity, he analyzes prices throughout the job. City Uniformed Construction Code (UCC) Inspectors issue

Comment 5

inspection stickers when they must approve a contractor's work. DHA technical employees will not approve a payment if a UCC Inspector has not issued a required approval. When a job is completed, the final payment is signed by the DHA employee, Chief Loan Advisor/Construction Inspector, Division Director and is then processed by a DHA accountant. The final check is not released until the contractor has provided the CBO and DHA a warranty and a standard release (Please see attached Exhibit B, RELEASE Form). The release is essentially a certification of the completion of the job.

We are, additionally, respectfully requesting that the OIG provide us a list of specific projects and payments that sum to the \$189,956 in unsupported drawdowns. This will enable the DHA to provide a detailed explanation for each drawdown.

- Certain drawdowns for building inspection projects were based on estimates and did not reconcile with the supporting documents. Since the adjustment records only showed a lump-sum amount without a detailed breakdown of the information, we were unable to determine whether the City made adequate adjustments for the estimates. The amount of unsupported drawdowns for these building inspection projects was \$83,877.

Response

Our Division of Inspections and Enforcement does have a response. In the meantime, in order to clarify the basis for the OIG's calculation of unsupported drawdowns, we are respectfully requesting a list of specific payments that sum to the \$83,877. This will enable Inspections and Enforcement to provide a detailed explanation for each drawdown.

- Records of overtime payments totaling \$59,006 for employees at the Department of Health and Human Services lacked information supporting that overtime was incurred for CDBG-funded activities. In addition, \$1,236 was ineligible since the payment was paid to an employee who did not perform any CDBG services.

Response

We are respectfully requesting specifics here, as well.

- The Division of Demolition and Clearance overdraw \$13,469 from CDBG funds without proof of actual expenses. Therefore, these excess funds are ineligible.

Response

Comment 6

Comment 6

Comment 6

We are respectfully requesting specifics here, as well.

Recommendations

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

- IA. Reimburse the CDBG program from nonfederal funds the \$246,523 in excessive drawdowns related to bond debt repayments.
- IB. Provide supporting documentation to HUD showing that the \$9.83 million in disbursements for bond principal and interest is eligible and in compliance with HUD regulations. Any amounts determined to be ineligible must be reimbursed to the CDBG program from nonfederal funds.
- IC. Establish and implement procedure to ensure that adequate documentation for all future bond payments is maintained and is an eligible expense of the program or discontinue making these payments. This would ensure that at least one year of future bond payments that amount to \$991,171 would be a cost savings, and these funds would be put to better use.
- ID. Determine the actual amount of unreported program income earned since 1999, which should include the interest and penalty payments received by the City. Then submit all supporting documents showing the eligibility and propriety of the program income that was earned and disbursed during the period. Any amounts determined to be ineligible must be reimbursed to the CDBG program from nonfederal funds.
- IE. Provide all supporting documentation showing that \$332,839 in unsupported drawdowns related to rehabilitation projects, building inspections, and employee overtime is eligible and in compliance with HUD regulations. Any amounts determined to be ineligible must be reimbursed to the CDBG program from nonfederal funds.
- IF. Reimburse the CDBG program from nonfederal funds the \$14,705 in excessive drawdowns related to demolition services and the salary paid to the employee who did not conduct CDBG activities.

Comment 6

Response

We will seriously consider all OIG recommendations. With regard to several issues, however, we would like clearer or more specific information. We would also hope that, in some cases, the OIG finds our replies to be acceptable to the extent that the draft findings can be resolved and not included in the final report.

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

The City had weaknesses in its financial management system. It did not always comply with HUD requirements to ensure that (1) administrative costs were reasonably expended in proportion to delivery costs, (2) adequate time distribution records were used to allocate personnel expenses to various programs, (3) accounting records were accurate, and (4) key positions had adequate separation of duties. This noncompliance occurred because the City did not develop and implement adequate procedures to ensure compliance with all HUD regulations. Consequently, funds allotted for administration may have been expended prematurely, CDBG funds may have been used to pay the salaries of employees not participating in CDBG activities, financial information may not have been accurate, and funds were not properly safeguarded as there was a lack of assurance that funds were being used for eligible purposes.

Excessive Administrative Costs Possible

Excessive administrative costs may have been charged to the City's CDBG program. Regulations at 24 CFR 570.206 provide for the payment of reasonable administrative costs related to the planning and execution of community development activities. The City expended more than \$1.77 million or 88 percent of its total budget for administrative costs during program year 2005, while delivery costs represented only 46 percent of the total budget for program delivery of \$8.08 million. Prudent business practices dictate that funds to administer an activity should be expended in proportion to expenses for the actual activity or program delivery. However, the City seems to be swiftly expending its administrative funds. This appears to be the result of having inadequate controls over costs charged to program administration. As a result, funds to pay for proper administration of the program may not be sufficient for later periods.

Response

The draft audit findings may or may not be correct, in general, but the logic of the OIG's reconstruction of activity delivery and general planning/administration costs is difficult for us to follow. HUD/CPD has always treated the administration vs. activity delivery distinction as one that leaves generous room for local discretion. And, again, they have closely monitored our activities. There is no record in the

Comment 7

Comment 7

last several years' HUD annual monitoring letters of any programmatic findings regarding our general planning and administration activities.

We do, on the other hand, have issues that we readily acknowledge regarding the timely obligation and expenditure of programmatic funds. What generally happens is that our administrative costs accrue and are paid by reimbursement immediately upon our receipt of entitlement funds, while the payment of programmatic costs cannot occur until other steps, e.g., contracts and environmental reviews, are completed. Hence, the cyclical expenditure patterns for administrative activities differ from those for programs.

**Lack of Adequate Time
Distribution Records**

The City did not have adequate time distribution records to account for the salaries being charged to the CDBG program. Therefore, salaries charged to the program may have been excessive. According to Office of Management and Budget Circular A-87, employees should be compensated for the time devoted to an activity and be identified specifically to the performance of those activities. The City did not track its employees' time by program activities. It charged to the CDBG program the full salary of many employees who performed additional functions not related to CDBG activities. For instance, two managers in the Division of Demolition and Clearance provided oversight to both CDBG- and non-CDBG-funded projects, but their salaries were completely paid from CDBG funds. As a result, personnel costs were not accurately charged to various programs; thus, CDBG funds could have been used to compensate employees who worked on non-CDBG-related activities and may have been ineligible.

Response

Due to the way our HUD/CPD monitors have allowed us to operate our program, time distribution has been a major issue only in the Div. of Housing Assistance. In order to resolve HUD concerns, the Division transferred two housing positions to the city budget so that its staff would be either CDBG/HOME or not.

With regard to Demolition/Clearance, by agreement with HUD we charge only emergency demolitions in L/M CTs/BGs to CDBG. We would find it difficult to require staff to monitor only the emergencies and look forward to working with CPD on means to accomplish that end.

Our new administration's intention, irrespective of the OIG letter, is to institute a general time distribution system that will be inclusive of CDBG. We are not there yet, but will provide an implementation timetable to CPD.

Comment 4

Inaccurate Accounting Records

The City's accounting records were not accurate, current, or complete. Office of Management and Budget Circular A-87, section C, entitled "Basic Guidelines," paragraph 1(j), requires that costs be adequately documented to be allowable under federal awards. City funds were used to pay for the expenses incurred by CDBG activities, and the City was later reimbursed from CDBG funds. To track the expenses, the City maintained its own accounting data in its PeopleSoft accounting system and kept its CDBG drawdown records in HUD's Integrated Disbursement and Information System. However, the City did not perform timely reconciliations between the two systems.

For example, the Department of Neighborhood and Recreational Services had to draw down funds from HUD to pay salaries for the employees who worked on the building inspection projects. However, the information entered into HUD's system was based on estimates due to delays in obtaining financial data such as employees' timesheets from the PeopleSoft system. Nevertheless, the department did not make timely adjustments to HUD's system to record accurate information until the end of the program year. As a result, identified accounting errors related to payroll estimates were not corrected in a timely manner and may have affected the overall accuracy of CDBG fund administration. The delayed reconciliation between the two systems was also noted for other departments and divisions including the Department of Health and Human Services. Moreover, the financial reports in the consolidated annual performance and evaluation report did not reconcile with each other. Therefore, the City cannot adequately ensure HUD and its citizens that its financial information is accurate, current, or complete.

Inadequate Separation of Duties for Bond Payments

There was inadequate separation of duties in processing Essex County Improvement Authority (ECIA) bond debt repayments. Regulations at 24 CFR 570.489(d) provide that a grantee must have adequate controls to ensure that all funds received are used in compliance with all applicable statutory and regulatory provisions. Adequate controls would include having key duties and responsibilities in authorizing, processing, recording, and reviewing transactions separated among different individuals. Managers should exercise appropriate oversight to ensure that individuals do not exceed or abuse their assigned authorities. However, the assistant treasurer of the City was the only person handling the ECIA bond debt repayments, including issuing the payments, authorizing the payments, sending out the payments, and keeping the records for the payments. No other staff members were responsible for reviewing or supervising his work. As a result, CDBG funds were not properly safeguarded, and the City cannot ensure that payments were properly authorized, processed, and recorded.

Comment 8

Response

There is a misunderstanding of the process of payment of debt service that resulted in this finding. The debt service schedule for any particular debt issuance is determined at the time of the financing. This debt service schedule is maintained in several areas including the Assistant Treasurers Office, the CFO, the City's Annual Audit and Annual Financial Statement. It is reviewed annually by the CFO for submission to Office of Management and Budget for inclusion in the City's operating budget. During the budget review process, the Director of OMB, the Business Administrator, and the Mayor and Municipal Council review this schedule. The debt payments requirements for the following year are also reported in the Annual Financial Statement and reviewed by the outside City auditors. See Exhibit F-2a. In addition, not only the City's auditor, but also the State of New Jersey, Department of Community Affairs, Division of Local Government Services, reviews the City's Budget and Annual Financial Statement annually. The budget is certified to by not only the CFO, the outside auditor, but also the Division of Local Government Services. During each of these review processes, detailed amortization schedules are supplied as part of the process.

The debt service payments are appropriated in the City's operating budget and payments made against those appropriations are recorded in the City's financial system. Specifically as it relates to payment of principal and interest to Trustee for debt service pertaining to the ECIA 1994 and 1999 Refunding, the Trustee has the amortization schedule and has been authorized to debit our bank account in accordance with that schedule. In order to record those expenses on the City's books of accounts, the Assistant Treasurer prepared a Service and Expense Order, which went through the standard City approval method. This process requires certification by receiver of goods and/or services and a payment authorization by City official. The documents are audited and reviewed by Accounts Payable and processed through for payment. The Treasurer's Office prints checks and another section in Accounts Payable reviewed those checks against the original service and expense order to insure it is for the correct amount and vendor. Checks were then given to Treasury for distribution. Attached is certification from US Bank who are Trustee for ECIA and have certified that all debt service for the 1994 and 1999 issues have been made in a timely fashion and in full. (Exhibit F-2b)

Specifically regarding the charging of CDBG funds for ECIA bond debt repayments, those payments were processed via the City's accounts payable system and required documents to be approved by authorized individuals within those departments. The Department of Development specifically prepared Service and Expense Orders and authorized same for repayments of this debt service. In this fashion the CDBG budget had to be approved by the Municipal Council to authorized use of CDBG funds for these purposes. The Department of Development had to prepare service and expense order and attach appropriate documentation (debt service schedule and budgetary authorization) and forward to Accounts Payable for processing. The documents contain the signature of both the

receiver of good and services, but also the individual authorizing payment. These individuals would be authorized staff from the Department of Development. Accounts Payable staff would then review the documents and, if complete, would be entered into financial system for payment. Once a check is printed via the financial system, it is again audited against the bill listing and service and expense order to insure it is for the correct amount and to the correct vendor.

Conclusions

The City incurred excessive administrative costs, lacked adequate time distribution records to track employees' time spent on CDBG activities, did not maintain accurate accounting and financial information, and did not properly separate duties in processing ECIA bond debt repayments. Based on these deficiencies, we concluded that there were control weaknesses in the City's financial management system.

Recommendations

We recommend that the director of BUD's New Jersey Office of Community Planning and Development instruct the City to

- 2A. Establish controls to ensure that administrative funds are expended in proportion to program delivery costs to ensure that administrative funds are available throughout the program delivery period without exceeding the budget.

Response

In the absence of clarification, we believe we accomplish this objective when one accounts for the timing issues that result from our late submissions/approvals of our entitlement grants.

- 2B. Develop and implement time distribution records to track its employees' time spent on various programs and ensure that salary costs charged to the CDBG programs are reasonable and properly supported.

Response

This will be accomplished, as appropriate, in due time.

- 2C. Establish an appropriate financial management system to ensure that all financial data are accurate, current, and complete and that timely adjustments are made when errors are recognized.

Response

Comment 9

Comment 4

Comment 4

Issues raised by OIG with regard to our financial management systems are being addressed.

- 2D. Implement adequate internal controls to ensure that key positions and duties are properly segregated among individuals and that managers provide appropriate supervision.

Response

This reasonable recommendation is being implemented.

Comment 4

Finding 3: The City Did Not Have Adequate Program Controls

The City did not implement proper program controls in accordance with HUD requirements. It did not adequately monitor its CDBG programs administered by its subgrantees and itself or properly document whether the programs were CDBG eligible, met one of the CDBG national objectives, and were accomplished in compliance with federal laws and contractual standards. This noncompliance occurred because the City did not develop and implement adequate control procedures to ensure compliance with all F-IUD regulations. As a result, it may lack procedures to detect deficiencies in carrying out CDBG activities and take necessary actions to correct or prevent potential problems.

Projects Not Adequately Monitored

Regulations at 24 CFR 570.50 1(b) provide that the recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. Subpart J of 24 CFR Part 85 states that grantees must monitor subgrantee activities to assure compliance with applicable federal requirements and that performance goals are being achieved. The City did not perform fiscal and/or programmatic reviews of its subgrantees and/or in-house projects for several years. For instance, the Division of Housing Assistance has not performed any fiscal or programmatic monitoring of its subgrantees since 2000. The Department of Health and Human Services has only conducted programmatic monitoring of its subgrantees since 1999 when the fiscal monitoring duty was taken over by the City's internal auditors. Further, the internal auditor last performed fiscal monitoring in January 2002. In addition, several in-house projects administered by the Department of Health and Human Services were not properly monitored because the monitors were not able to obtain the necessary cooperation from individuals who were in charge of projects such as the Pediatric Van Project. Without adequate monitoring, there is no assurance that activities are being accomplished according to program requirements and that financial information is accurate and properly supported.

Comment 4

Response

The DHA does not have dedicated monitoring staff, but it has developed a plan and procedures to monitor CBO rehabilitation projects. Effective immediately, each new CBO will be pre-audited and a team of DHA employees will monitor each CBO at least once per year.

Please see Exhibits C and D for evidence of the remedial policies and procedures HHS is immediately implementing.

Eligibility Not Evident

The City did not maintain documentation to support whether CDBG activities were eligible and met the national objectives. Two of the seven redevelopment projects funded by Essex County Improvement Authority (ECIA) bond proceeds (see finding I) were either canceled or replaced with another project. However, the City did not provide adequate documentation to explain why the project was canceled, how much CDBG funding was disbursed before the cancellation, or what the City planned for the remaining budget. Therefore, adequate information was not furnished by the City to provide a reason for changing the use of the real property or justify the eligibility of the replacement project as stated in 24 CFR 570.489(j). Moreover, the City did not inform HUD and its citizens of these changes as required by HUD regulations and its own policies. We attribute these deficiencies to a lack of controls to ensure that activities meet program eligibility requirements.

Response

The areas that benefit from the changed uses remain low/moderate-income; the same slum and blighted conditions that sparked our initial decision to redevelop pertain; the new uses to which the land has been put are still commercial. While we should, indeed, have exercised due diligence in adhering to the letter of the regulations, we believe our use of CDBG funds is within the broad intent of the program.

This deficiency was also evidenced in many projects administered by the City's Division of Housing Assistance (DHA) as documentation supporting that the work was completed and met program objectives and standards was not available. One example is the rehabilitation projects discussed in finding I, for which the City did not provide the documentation to support the eligibility of the activity. Consequently, by not maintaining the appropriate evidence in its files, the City could not demonstrate that some activities met at least one of the three CDBG national objectives as required by 24 CFR 570.200(a).

Comment 10

Comment 11

Response

As a rule, the Coordinator of Federal and State Aid prepares eligibility determination forms for each activity and submits a copy of these forms to the DHA. Additionally, the DHA determines whether activities listed in each CBO's proposal are eligible before developing and executing a contract. Although an eligibility determination form was not placed in each CBO project file, all rehabilitation construction projects benefited low and moderate-income persons. Effective immediately, upon receipt the DHA will place eligibility determination forms in each CBO project file.

Conclusions

The City did not adequately monitor its CDBG projects, maintain proper documentation to support whether these CDBG activities met the national objectives, and determine whether the activities were completed in compliance with requirements. Therefore, the City did not have adequate program controls over its CDBG activities.

Response

We do not believe this to be the case for most of our activities most of the time. We acknowledge, however, that we have exercised due diligence in organizing our determinations and records in a manner that would be apparent to external reviewers. We are correcting this inadequacy and look forward to demonstrating our improvements to CPD.

Comment 12

Recommendations

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

- 3A. Develop and implement an adequate project monitoring system to ensure that projects comply with HUD regulations and the objectives of the program. The City should resume both fiscal and programmatic monitoring reviews of all of the projects carried out by City agencies and/or subgrantees.

Response

We are already implementing such corrective measures.

Comment 4

- 3B. Establish and implement policies and procedures to ensure that all funded activities meet at least one of the three CDBG national objectives. Procedures should also require that documentation supporting the eligibility of projects be maintained in City files and any cancellations or changes to the nature of

the projects or national objectives should be disclosed to the HUD Office of Community Planning and Development field office and the citizens of the City.

Response

We generally follow these mandated policies and procedures quite carefully and will be certain, in the future, to more carefully handle and maintain required documentation.

Concluding City Responses

As a new administration – the first in 20 years – that is assiduously endeavoring to diagnose systemic weaknesses in the administration of city programs and implement optimal solutions, we appreciate the OIG audit, which confirms many of our findings. The information we include in our response will confirm our determination to correct the deficiencies we inherited. In some cases, however, we are respectfully requesting further clarity and specificity, and additional time to reply. Finally, in a few selected instances, we hope the OIG will seriously consider our respectful disagreement and the reasons we provide for our conclusions. As we state at several points in our responses to individual findings, we look forward to working in partnership with CPD to greatly improve our program in the interest of our lower income citizens.

Comment 4

Comment 13

OIG Evaluation of Auditee Comments

- Comment 1** City officials appreciated the thoroughness and professionalism of the audit staff and considered our report to be constructive, but had some areas where they had disagreements or needed clarification of the findings. They indicated that they would provide additional information that should resolve the issues raised. However, we reviewed the additional information provided by the City and it did not result in any changes to our conclusions or the report. (See Also Comment 13)
- Comment 2** City officials agreed that they did not maintain the records related to the bond financing as required by the law. However, City officials stated that they considered the bond debt repayment issue as “settled”, since HUD CPD had never questioned it. City officials indicated that they complied with the requirements for eligibility, national objectives, environment and financial management. They provided additional documents at the exit conference; however, they did not provide sufficient information to justify the eligibility and/or reasonableness of the bond debt payments and the expenses associated with the seven underlying projects. Based on our review of the files provided by the City during our fieldwork and at exit conference, we concluded that the bond payments were not adequately supported.
- Comment 3** City officials did not provide a written response regarding the \$246,523 in excessive drawdowns from CDBG funds for the bond payments. However, at the exit conference City officials stated that they would provide a response after they have reviewed this area. As of the report issue date, no response was provided.
- Comment 4** The comments and actions of the City officials are responsive to the finding.
- Comment 5** City officials indicated that its Division of Housing Assistance (DHA) files contained sufficient information to document payments. During the course of the audit we were provided with a backdated City Inspector’s certification for payment and work completion, however, this certification was on the letterhead of the current administration, which did not take office until July 1, 2006. As such, we do not consider this a reliable document to support that the work was completed before the payment was made in 2005. In addition, although the Cost Estimate/Work Write-up prepared by the Division’s technical employees and the final standard release forms were mentioned in the City’s comments, they were not provided to us. City officials later agreed that the eligibility determination form was not in the project files. Further, although provided during the audit, per the City’s request, we presented additional information regarding the \$189,956 in unsupported drawdowns after the exit conference; however, City officials did not provide a revised response.
- Comment 6** City officials requested specific information regarding the unsupported drawdowns. As mentioned above, we provided detailed information for the

unsupported drawdowns to City employees during the audit and again after the exit conference; however, City officials did not provide a revised response.

- Comment 7** City officials indicated that it can accrue and pay administrative costs immediately but that there is a lag in the payment of program delivery costs, as other steps have to occur (e.g. contracts and environmental reviews). The City wanted clarification of the issues regarding the excessive administrative costs. Thus, we explained to City officials that the expenditure rate for administrative costs was significantly higher than the rate for program delivery costs, and might result in insufficient administrative funds being available to carry out CDBG activities to the citizens of Newark in the future. As a result, controls need to be developed to ensure that administrative funds are not used up before the program is delivered.
- Comment 8** City officials stated that there is a misunderstanding of the process of payment of debt service. They provided an extensive narrative describing the controls and separation of duties regarding bond payments. However, the documentation provided by the City did not show that all the procedures and controls enumerated were followed. As such, the documentation provided did not adequately show that the bond debt payments had been reviewed, approved and processed by multiple individuals before the payments were made.
- Comment 9** City officials stated that recommendation 2A has been accomplished if you consider the timing differences due to the late submissions/approvals of their entitlement grants. However, because the late submission and approvals of entitlement grants may cause the rate of administrative costs to exceed that of program expenditures, controls need to be implemented to ensure that administrative funds are available throughout the entire grant period and not exhausted before the program is delivered.
- Comment 10** City officials indicated that they should have exercised due diligence to comply with the regulations, but claims that their use of CDBG funds benefited low/moderate-income areas and is within the broad intent of the program. However, without adequate supporting documents, we cannot evaluate the eligibility and reasonableness of the CDBG funds disbursed.
- Comment 11** City officials agreed that the eligibility determination form was not placed in the file for the rehabilitation projects carried out by the Division of Housing Assistance, but stated that all these projects benefited low/moderated-income people. However, without adequate supporting documentation we cannot determine if the use of funds was in fact eligible.
- Comment 12** City officials stated that they complied with regulations in administrating most of its CDBG activities, however, they indicated that they are correcting any

inadequacy and look forward to demonstrating improvements to CPD. As such, the comments and actions of the City officials are responsive to the finding.

Comment 13 City officials requested that we provide them additional information and additional time to reply to the issues raised. They requested that we consider their disagreements and the reasons for their conclusions. City officials indicated that they looked forward to improving their program in partnership with CPD. We provided City officials with information that they requested during the course of the audit and following the exit conference; however, these officials did not provide a revised response. We also reviewed additional documentation provided by the City officials and considered it in our evaluation of their responses. However, the additional information provided did not result in any changes to our conclusions.