



City of Elizabeth, New Jersey Did Not Always Administer Its Community Development Block Grant Program in Accordance With Regulations



Issue Date: August 15, 2012

Audit Report Number: 2012-NY-1011

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: The City of Elizabeth, NJ, Did Not Always Administer Its Community
Development Block Grant Program in Accordance With Regulations

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG's), final results of our review of the City of Elizabeth, NJ's Community Development and Block Grant Program.

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



August 15, 2012

The City of Elizabeth, NJ, Did not Always Administer Its Community Development Block Grant Program in Accordance With Regulations

Highlights

Audit Report 2012-NY-1011

What We Audited and Why

We audited the City of Elizabeth, NJ's Community Development Block Grant (CDBG) program in support of the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) goal to contribute to improving HUD's execution of and accountability for its fiscal responsibilities. We selected the City after completing a risk analysis of CDBG grantees administered by the HUD Newark, NJ, field office. This assessment considered funds received, HUD's risk assessment score, and program information reported in HUD's Integrated Disbursement and Information System. The objective of the audit was to determine whether City officials established and implemented adequate controls to ensure that the City's CDBG program was administered in accordance with Federal regulations and CDBG program requirements.

What We Recommend

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct City officials to (1) reimburse the City's CDBG line of credit from non-Federal funds for ineligible expenses of \$399,093, (2) provide documentation to support expenditure of \$193,774, and if such documentation cannot be provided, reimburse the City's CDBG line of credit from non-Federal funds, (3) provide documentation to enable HUD to determine whether the City was entitled to program income of \$263,938, (4) reimburse the CDBG line of credit for unreported program income of \$606,460, (5) impose liens or other appropriate notices of record on two real properties assisted with more than \$4.2 million in Federal Funds to ensure that the HUD's and the City's interest is adequately protected, and (6) strengthen internal controls to ensure that the City's CDBG program is administered in accordance with Federal regulations and program requirements.

What We Found

City officials did not always administer the City's CDBG program in accordance with Federal regulations and CDBG program requirements. Specifically, CDBG funds were expended for ineligible and unsupported costs, program income was not properly recognized and used, liens were not imposed on assisted properties, and subrecipient monitoring and compliance with other program requirements were not adequate. These conditions existed because of weaknesses in the City's financial and administrative controls and officials' unfamiliarity with program regulations. Consequently, (1) \$399,093 was expended on ineligible costs, (2) \$193,774 was expended on unsupported costs, (3) program income of \$263,938 may not have been realized, (4) program income of \$606,460 was not reported and made available for eligible CDBG eligible activities, (5) HUD's interest in two assisted properties totaling more than \$4.2 million was not protected, and (6) officials did not adequately monitor subrecipients and comply with program administrative requirements.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: Weaknesses in Financial and Program Controls Resulted in Ineligible and Unsupported Costs	5
Finding 2: Weaknesses in Program Controls Caused Program Income Not to be Realized	9
Finding 3: Weaknesses in Administrative Controls Caused Noncompliance With CDBG Program Requirements	13
Scope and Methodology	16
Internal Controls	18
Appendixes	
A. Schedule of Questioned Costs and Funds To Be Put to Better Use	20
B. Auditee Comments and OIG's Evaluation	21

BACKGROUND AND OBJECTIVES

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 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 to (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.

The U.S. Department of Housing and Urban Development (HUD) awarded the City of Elizabeth, NJ, more than \$2 and \$2.2 million in CDBG funds in program years 2009 and 2010, respectively. The City Department of Planning and Community Development administers the program for the City. Department officials annually awarded \$600,000 of their funds to a subrecipient, the Elizabeth Development Corporation, a nonprofit organization, to carry out different economic development activities including acquisition, rehabilitation, and construction.

The objective of the audit was to determine whether City officials established and implemented adequate controls to ensure that the City's CDBG program was administered in accordance with Federal regulations and program requirements.

RESULTS OF AUDIT

Finding 1: Weaknesses in Financial and Program Controls Resulted in Ineligible and Unsupported Costs

City officials expended CDBG funds for ineligible and unsupported costs. Specifically, \$399,093 was incurred for activities ineligible for CDBG assistance, and costs of \$193,774 lacked adequate support to determine that they furthered program objectives. This condition occurred because City officials did not establish adequate financial and program controls to provide assurance that CDBG-funded activities administered directly by the City or through its subrecipients complied with program regulations. Consequently, funds available for eligible activities were reduced, and City officials could not adequately assure HUD that costs incurred were for eligible activities.

Ineligible Loans

Elizabeth Development Corporation officials authorized a \$20,000 microenterprise loan to an entity that did not qualify for such a loan. Section 102 (a)(22) of the Housing and Community Development Act of 1974, as well as the City's economic development policy, defines a microenterprise entity as a small business with five or fewer employees. In this case, the entity approved for the loan had 16 employees and, therefore, did not qualify under the City's definition as a small business. Consequently, the loan represented an ineligible use of CDBG funds. This noncompliance occurred due to lax oversight during the loan approval process. When we advised City officials of this condition, they obtained reimbursement from the subrecipient, thus ensuring that these funds would be put to better use.

In July 2007, Elizabeth Development Corporation officials also authorized a \$150,000 direct loan from CDBG program income to a commercial enterprise for economic development activity that did not comply with the Corporation's underwriting requirements as detailed in its general lending policy, a board of directors resolution, and its direct loan commitment letter. Specifically, the loan was granted despite the fact that the Corporation did not obtain proof that the borrower had disbursed the funds; the borrower provided tax returns for only 1 of the 3 years required; and the loan commitment was not accepted until June 17, 2007, although it was to have been accepted on or before April 28, 2007. Further, although required by the loan provisions, annual personal income tax returns for the loan guarantors and annual corporate financial statements prepared by a certified public accountant were not provided. Additionally, while the borrower defaulted on the loan, which was guaranteed by three guarantors, in July 2009, Corporation officials neither enforced the unlimited continuing guarantee executed by the three guarantors nor initiated legal action against the borrower, as authorized, when the loan was 90 days past due. Therefore, CDBG funds of

\$150,000 were disbursed for an ineligible loan and, thus, were not available for other eligible loans. We attribute this deficiency to inadequate monitoring of the City's subrecipient.

Ineligible Costs

City officials used \$45,000 in CDBG funds to reimburse the City's general fund for ineligible CDBG costs, which were originally authorized and paid from the City's general fund account. Contrary to 2 CFR (Code of Federal Regulations) Part 225 Appendix A, (C) basic guidelines (c), which provides that costs must be authorized to be allowable, these costs were not authorized as eligible CDBG costs. We attribute this deficiency to the City officials' unawareness that these costs were initially approved to be paid from the City's general fund account. Once City officials were made aware of this condition, they reimbursed the City's CDBG program, thus ensuring that the \$45,000 would be put to better use.

Elizabeth Development Corporation officials funded a reserve account with \$23,647 in CDBG program income earned from rent from a CDBG-assisted real property. Regulations at 2 CFR Part 230, Appendix (B) selected items of cost (9) contingency provisions, prohibit the use of funds for a contingency reserve unless required by contract. In this case, no such contractual requirement was documented. Consequently, Corporation officials erroneously reserved and did not report \$23,647 as program income in HUD's Integrated Disbursement and Information System. We attribute this deficiency to City officials' unfamiliarity with HUD regulations.

Corporation officials expended \$15,666 on relocation and entertainment and other personal costs that were unallowable. Regulations at 24 CFR 570.606(b)(2) provide that CDBG funds can be used for relocation of a displaced entity, which is an entity that is relocated permanently and involuntarily as a direct result of rehabilitation, demolition, or acquisition for an activity assisted. However, the Corporation's move was reportedly made to save rental costs and, therefore, would not qualify as a displaced entity. In addition, regulations at 2 CFR Part 230, Appendix (B) selected items of cost (14), (16) and (19) provide that CDBG funds cannot be used to pay for goods or services for personal use, entertainment, or fines. We attribute this deficiency to City and Corporation officials' unfamiliarity with HUD regulations and inadequate monitoring of the Corporation by the City. City officials acknowledged these ineligible expenses and provided cancelled checks to document that the City received \$15,666 from the Corporation for the costs prior to the exit conference.

City officials awarded \$364,330 to the Corporation to conduct a feasibility study to construct a new office for the Corporation. Of that amount, \$144,780 was used to pay operating and administrative costs incurred by the Corporation and appraisal and architect or consultant costs. However, the \$144,780 was expended before the City completed an environmental review and submitted a request for

release of funds. Regulations at 24 CFR 58.22(a) prohibit commitment of CDBG funds on development activity until HUD or the State has approved the recipient's request for release of funds and the related environmental certification from the responsible entity. This deficiency occurred because City officials overlooked the environmental review process. In addition, the proposed development was later canceled because local businesses objected, citing the negative impact the loss of parking space for shoppers would have on their businesses if the Corporation constructed its new office on the site.

Unsupported Costs

Documentation was inadequate to support \$193,774 in payroll and operating expenses associated with the Corporation. Corporation officials did not provide adequate and complete documentation, including general ledgers, vendors' invoices, employee payroll and summary time-sheet reports, and canceled checks to support the use of CDBG program funds. Although regulations at 2 CFR Part 230, Appendix (A) general principles (A) basic consideration, require costs to be adequately supported and the City's accounting policy provided that requests for payments needed to be adequately supported to be an allowable cost, adequate support was not provided. Therefore, there was no assurance that the \$193,774 was used for eligible and reasonable CDBG expenses. We generally attribute this deficiency to weaknesses in the City's financial management and subrecipient monitoring controls.

Conclusion

The City's and its subrecipient's officials expended \$592,867 in CDBG funds for ineligible and unsupported CDBG costs. We attribute these deficiencies to officials' unfamiliarity with HUD regulations and inadequate monitoring of the City's subrecipient. As a result of these deficiencies, \$399,093 was unavailable for other eligible CDBG activities, and the City could not adequately assure HUD that \$193,774 was expended for allowable costs.

Recommendations

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

- 1A. Provide documentation showing the repayment of the ineligible \$20,000 microenterprise loan to ensure that these ineligible amounts were reimbursed to the CDBG program.
- 1B. Reimburse the City's CDBG line of credit from non-Federal funds for the \$150,000 ineligible loan.

- 1C. Provide documentation showing the repayment of the \$45,000 repaid from the City's general fund to ensure that these ineligible amounts were reimbursed to the CDBG program.
- 1D. Reimburse the City's CDBG line of credit from non-Federal funds for the \$23,647 expended to fund an ineligible contingency reserve.
- 1E. Reimburse the City's CDBG line of credit from non-Federal funds for the \$15,666 expended for subrecipient relocation and entertainment costs.
- 1F. Reimburse the City's CDBG line of credit from non-Federal funds for the \$144,780 expended for a feasibility study before the City conducted an environmental review and requested approval for the release of the funds.
- 1G. Strengthen internal control procedures to ensure compliance with all CDBG requirements and cost allowability before disbursing CDBG funds.
- 1H. Provide adequate documentation to support the \$193,774 in Elizabeth Development Corporation payroll and operating expenses and if such documentation cannot be provided, reimburse the City's CDBG line of credit from non-Federal funds.
- 1I. Strengthen internal control procedures to ensure that adequate and complete supporting documentation is obtained and maintained before reimbursing the City subrecipients for eligible CDBG costs.

Finding 2: Weaknesses in Program Controls Caused Program Income Not To Be Realized

City officials did not report and remit to the City's CDBG line of credit program income realized from activities previously assisted with CDBG funds as required by regulations. We attribute this deficiency to City officials' unfamiliarity with HUD regulations. As a result, \$606,460 in program income was not made available for eligible CDBG program activities, and the City may be entitled to an additional \$263,938 in program income.

Program Income From Property Dispositions Not Recognized

City officials neither reported nor remitted CDBG program income of \$475,339 realized from the disposition of CDBG-assisted properties. Regulations at 24 CFR 570.505 require that if the use of real property assisted with CDBG funds does not qualify as meeting one of the three national CDBG program objectives, the CDBG program is to be reimbursed in the amount of the current fair market value of the property, less any portion of the value attributable to expenditures of non-CDBG funds for acquisition of and improvement to the property. Regulations at 24 CFR 570.500 further provide that CDBG program income includes proceeds from the disposition by sale or long-term lease of real property purchased or improved with CDBG funds.

Specifically, officials of the City's subrecipient, the Elizabeth Development Corporation, used \$400,000 in CDBG funds to purchase a church in 1986 to eliminate slums and blight. However, Corporation officials sold the property to a developer in March 1993 for \$470,000 to create a theater to provide performances to the community at a nominal fee. The property was purchased with \$10,000 in cash and a \$460,000 CDBG loan with a 1 percent annual interest rate. The theater was not successful and closed in May 2004, and the developer sold the property to another developer for \$1.35 million on December 21, 2004. While City officials had attached a lien to the property in December 1988, the lien was discharged in February 2005, so the first developer was able to sell the property to the second developer unencumbered. City officials did not claim any CDBG program income realized from the net gain on the sale, which we estimate to be \$531,079.¹ Consequently, this amount was not available to fund eligible CDBG activities. We attribute this deficiency to City officials' unfamiliarity with regulations related to recognition of program income and inadequate oversight.

¹ We estimated the City's share of program income to be \$531,079 by subtracting outstanding loan balances, owner equity and contribution, and other fees of \$720,759 from the \$1.35 million sale price, which totaled \$629,241. We then multiplied that amount by 84.4 percent, which represented the City's percentage contribution to the initial property value of \$545,000, resulting in a total of \$531,079.

At the exit conference City officials provided documentation to support an alternative calculation of program income that results in program income of \$267,141 rather than \$531,079. While there is merit to this calculation, it may not be the most reasonable because it does not account for the risk to the CDBG funds by assuming that the CDBG loan and non-CDBG sources carried the same annual rate, and thus risk. Further, the funding sources used to repay the CDBG and non-CDBG sources were not documented in the files; therefore, these documents supporting that investor equity was used to repay the loans needs to be provided. However, acknowledging the City officials' comment that HUD rules and regulations do not provide for clearly defined guidance for selective financial transactions, we have revised the audit report to reduce the unreported and unremitted program income as \$267,141 as proposed by the City officials and reclassify the difference of \$263,938 as unsupported.

Corporation officials also purchased four properties with \$839,012 in CDBG and Neighborhood Initiative Grant funds in 2003 and 2005 to construct a mixed-use residential and commercial project with assistance from the Housing Authority of the City of Elizabeth. In March 2006, Corporation officials transferred ownership of the properties to the City, and in September 2009, City officials transferred ownership to the Authority. In June 2010, the Authority sold the properties to the 205 First Street Urban Renewal LP for \$300,000, of which \$208,198² should be considered as CDBG program income associated with the four real properties. However, City officials did not record or remit this CDBG program income. We attribute this deficiency to the City's inadequate monitoring of its subrecipient. Therefore, \$208,198 in CDBG program income was not available to be used for eligible CDBG program activities.

Rental Income From Assisted Property Not Recognized

City officials did not collect rent from a CDBG-assisted property, thus not recognizing program income. Regulations at 24 CFR 570.500 provide that CDBG program income includes gross income from the use or rental of real property, owned by the recipient or a subrecipient, that was constructed or improved with CDBG program funds, less costs incidental to generation of the income. However, City officials had not charged rent—and, therefore, not recognized associated program income—to the commercial space used by the Corporation. We attribute this deficiency to City officials' unfamiliarity with CDBG program requirements. Therefore, the City did not realize program income that should have been generated from the use of the commercial space, and this income was not remitted to the City's CDBG line of credit to be used for eligible CDBG activities.

² The City's share of program income was estimated to be \$208,198 by multiplying the sales proceeds of \$300,000 by the square footage (71.4 percent) associated with four of the five properties that were CDBG assisted, which yielded \$214,200 as the four CDBG-assisted properties' share of the proceeds. Then \$6,002, representing non-CDBG funds used to purchase the property, was subtracted from the \$214,200, yielding a total of \$208,198.

Program Income From CDBG Loan Repayment Not Recognized

City officials did not report or remit to the CDBG line of credit CDBG program income of \$131,121 associated with the repayment of a CDBG loan. Regulations at 24 CFR 570.500 provide that CDBG program income includes payments of principal and interest on loans made using CDBG funds. In addition, City officials used these repayment proceeds to make a housing construction loan to a housing developer without recording the loan in HUD's Integrated Disbursement and Information System. Regulations at 24 CFR 84.21 require that CDBG recipients maintain a financial management system that provides accurate, current, and complete records of financial results and that the results identify adequately the source and application of funds for federally sponsored activity. By not recording this loan as a CDBG activity, the City could not assure HUD that the future loan repayment of \$131,121 would be recorded as CDBG program income in HUD's Integrated Disbursement and Information System and would be remitted to the City's CDBG line of credit. This deficiency occurred because of City officials' unfamiliarity with HUD regulations and weaknesses in controls over the reporting of program income.

Conclusion

City officials did not recognize, record in HUD's Integrated Disbursement and Information System, or remit \$870,398 in program income to the City's CDBG line of credit. The CDBG program income was realized upon the disposition of real property previously assisted with CDBG funds and repayment of a loan previously made with CDBG funds. We attribute this condition to City officials' unfamiliarity with HUD regulations. Consequently, these funds were not available to assist other CDBG eligible activities.

Recommendations

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

- 2A. Reimburse the City's CDBG line of credit \$ \$475,339 from non-Federal funds for the unreported (\$267,141) and unremitted (\$208,198) in program income from the sale of the theater and four properties; and record these reimbursements in HUD's Integrated Disbursement and Information System as CDBG program income.

- 2B. Provide documentation to enable HUD to determine whether the City is entitled to additional program income of \$263,938 from the disposition of the Church property.
- 2C. Record in HUD's Integrated Disbursement and Information System the \$131,121 loan executed with program income, thus ensuring that HUD's interest in this loan will be protected.
- 2D. Provide documentation to establish a fair market rent for the commercial space occupied by the Elizabeth Development Corporation or justify the basis for not charging rent. If no justification is provided, any past rent that should have been charged, as well as any future rental income, should be collected and remitted to the City's CDBG line of credit.
- 2E. Develop and implement internal controls to ensure that CDBG program income is recognized, recorded in HUD's Integrated Disbursement and Information System, and remitted to the City's CDBG line of credit as required by CDBG program requirements.
- 2F. Establish controls to ensure that commercial rents of CDBG-assisted properties are set at market rates or if lower, that the rental charge is justified.

Finding 3: Weaknesses in Administrative Controls Caused Noncompliance With CDBG Program Requirements

City officials' administration of the City's CDBG funds did not always comply with program requirements. Specifically, City officials did not (1) impose liens or deed restrictions on two real properties assisted with CDBG and Neighborhood Initiative Grant funds, (2) always conduct required monitoring of subrecipients or ensure that the subrecipients had implemented recommended corrective action, and (3) always request city council approval or City citizen participation when substantial amendments were made to the City action plan. We attributed these deficiencies to City officials' unfamiliarity with program requirements and weaknesses in program administration. Consequently, HUD's and the City's \$4.2 million interest in the assisted properties was not protected, and HUD could not be assured that subrecipients complied with CDBG program requirements and substantial amendments to the City's annual action plans were properly authorized.

Liens Not Recorded on Real Properties Assisted With CDBG and Neighborhood Initiative Grant Funds

City officials provided more than \$4.2 million in CDBG and Neighborhood Initiative Grant funds to the Elizabeth Development Corporation for two real properties. Regulations at 24 CFR 84.37 provide 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. Further, the City's CDBG subrecipient agreements required that any real property purchased by a subrecipient financed by the City be subject to a mortgage held by the City. While Corporation officials were provided more than \$1.4 million for the acquisition and rehabilitation of property formerly known as the United County Trust Building and more than \$2.79 million³ for the acquisition and construction of property located at 205-215 First Street, Elizabeth, NJ, liens were not recorded on the properties.

This deficiency occurred because City officials did not properly monitor the City's subrecipients to ensure that the subrecipients were aware of, and complied with, CDBG program requirements. Therefore, (1) HUD's and the City's interest of more than \$4.2 million was not protected against any future disposition of the properties, thereby providing no assurance that proceeds from selling the two assisted properties would be returned to the CDBG line of credit, and (2) rental

³ City documents disclosed that more than \$3 million was used to acquire four real properties for construction of the 205-215 mixed-use project, developing the commercial space of the project, and preparing the space for the Elizabeth Development Corporation business. However, the \$3 million was reduced by costs already questioned in findings 1 and 2. Therefore, the amount of the lien should be around \$2.79 million.

income associated with the use of real property constructed with CDBG funds had not been remitted to the City's CDBG line of credit.

Inadequate Monitoring of the City Subrecipients

City officials did not adequately monitor the City's subrecipients because a risk analysis of subrecipients and monitoring were not conducted with the prescribed frequency and the City did not always follow up to ensure that recommended actions to correct deficiencies were implemented by the subrecipients. Regulations at 24 CFR 570.501(a) provide that grantees are responsible for determining the adequacy of subrecipient performance and taking appropriate action when performance problems arise.

The City's annual action plan required that every subrecipient receive an annual monitoring and that the Elizabeth Development Corporation be monitored quarterly. In addition, the City's monitoring policy required City officials to conduct fiscal monitoring of all subrecipients annually and that the fiscal monitoring include analysis of vouchers and budgets, examination of journal entries and the general ledger, review of relevant bank statements, review of source documentation, and analysis of internal controls. However, during CDBG program year 2009 (July 1, 2009, through June 30, 2010), annual monitoring was performed on only two of the City's 37 subrecipients, one of which was the Corporation, which should have been monitored quarterly. During CDBG program year 2010, the City did not monitor any of its subrecipients. In addition, City officials did not ensure that corrective action was taken in response to deficiencies noted during the monitoring that was conducted. These deficiencies occurred because City officials did not adhere to the City's monitoring policy. Therefore, City officials could not assure HUD that the City's subrecipients complied with CDBG program requirements.

Lack of City Council Approval and Citizen Participation

City officials reallocated \$378,725 of the City's CDBG program year 2009 funds, representing more than 20 percent of that initially reported, without an amended city council resolution and citizen participation as required. Regulations at 24 CFR 91.505(b) provide that a grantee must identify in its citizen participation plan the criteria it will use to determine what constitutes a plan's substantial amendment, which is subject to a citizen participation process.⁴ The City's citizen participation plan provided that any increase or decrease in an adopted activity amounting to 20 percent or more of the original allocation and any

⁴ Citizen participation provisions require that the City provide citizens with reasonable notice and an opportunity to comment on substantial amendments by publishing the amendments not less than 30 days before submission to HUD.

addition or deletion of published activities in their entirety would be a substantial change requiring an amendment. Further the City's subrecipient agreements required that any reallocation of funds exceeding 20 percent of the total amount of funds under contract would require city council approval. These deficiencies occurred because City officials were not aware of the substantial changes or amendments made to the City's program years 2009 and 2010 action plans and did not amend the City's action plan for program year 2010 to correctly report the City's economic development activities.

Conclusion

City officials did not impose liens on real properties assisted with CDBG and Neighborhood Initiative Grant funds, properly monitor the City's subrecipients, always properly report amendments to the City's action plan or correct errors in previously approved action plans. As a result, HUD's and the City's interest in the more than \$4.2 million provided to CDBG- and Neighborhood Initiative Grant-assisted properties would not be protected if the properties were sold, and City officials could not assure HUD that the City's subrecipients complied with CDBG program requirements and that the City's annual action plans properly reported City activity.

Recommendations

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

- 3A. Record liens or other appropriate notices of record on the two real properties assisted with CDBG and Neighborhood Initiative Grant funds to ensure that HUD's and the City's \$4,205,735 interest in these properties is adequately protected so that these funds would be reimbursed to the program upon disposition of the properties. If liens are not recorded, City official should reimburse the City's CDBG line of credit the more than \$4.2 million from non-Federal funds.
- 3B. Strengthen subrecipient monitoring procedures to ensure that monitoring reviews are conducted, recommended corrective action is implemented, and an annual subrecipients' risk analysis is performed as required by the City's monitoring policy.
- 3C. Strengthen administrative procedures to ensure compliance with citizen participation requirements and the city council's approval process before amending previously approved CDBG-assisted economic activities.

SCOPE AND METHODOLOGY

The audit focused on whether officials of the City established and implemented adequate controls to ensure that its CDBG program was administered in accordance with CDBG program requirements.

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, the City's Department of Planning and Community Development (grantee), and the Elizabeth Development Corporation (the City's major subrecipient) to further our understanding of the City's CDBG program.
- Obtained an understanding of the City's management controls and procedures through analysis of the City's responses to management control questionnaires.
- Reviewed the City's consolidated annual performance and evaluation reports and action plans for CDBG program years 2009 and 2010 to gather data on the City's expenditures.
- Reviewed the City's and the Corporation's audited financial statements for the fiscal years ending June 30, 2009 and 2010, to further our understanding of the City's programs and identify any issues for follow-up.
- Analyzed reports from HUD's computer systems, including the Integrated Disbursement and Information System, to document City disbursements and activities. Our assessment of the reliability of the data in these systems was limited to the data sampled, which was reconciled to the City's records.
- Reviewed the City's organizational chart and the City's and Corporation's policies, including the City's economic development, monitoring, procurement, and accounting policies, as well as the Corporation's general lending policy.
- Reviewed subrecipient agreements between the City and the Corporation.
- Reviewed city council resolutions for CDBG program years 2009 and 2010.
- Reviewed the City's monitoring reports of its subrecipients for CDBG program years 2008 and 2009.
- Selected a nonstatistical sample of more than \$1.1 million in CDBG drawdowns, representing approximately 24 percent of total drawdowns of more than \$4.8 million, for

program years 2009 and 2010. We later extended the sample to include an additional \$526,760 from four drawdowns made before and after CDBG program years 2009 and 2010 to include economic development activities that were canceled or had a very slow progress rate. The total selected drawdowns of more than \$1.6 million were associated with 14 CDBG activities. For the sampled items, we reviewed documentation supporting the amount drawn down, such as vendor invoices, contractor requests for payment, City and Corporation employee payroll data, canceled checks, bank statements, and general ledgers. The samples were not selected statistically, and, therefore, the results of our review cannot be projected to the universe.

- Reviewed documentation included in case files associated with the 14 CDBG activities to determine whether officials from the City and the Corporation followed CDBG program requirements and Federal regulations when establishing and carrying out the 14 activities. The samples were not selected statistically, and, therefore, the results of our review cannot be projected to the universe.

The audit generally covered the period July 1, 2009, through June 30, 2011, and was extended as needed to accomplish our objective. We performed our audit fieldwork from November 2011 through April 2012 at the City's Department of Planning and Community Development.

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

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit 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 City did not establish or implement adequate internal controls to ensure that CDBG funds were expended on only eligible and supported costs (see finding 1).
- The City did not establish or implement adequate internal controls to ensure that the City's CDBG program was administered in accordance with CDBG program requirements and Federal regulations (see finding 2 and 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 4/
1A	\$20,000		
1B	150,000		
1C	45,000		
1D	23,647		
1E	15,666		
1F	144,780		
1H		\$193,774	
2A			\$475,339
2B		263,938	
2C			131,121
3A			4,205,735
	\$399,093	\$457,712	\$4,812,195

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. If HUD implements the recommendation to report and remit program income of \$475,339 the funds will be available for eligible CDBG purposes, and if HUD implements the recommendation to record the unreported loan, \$131,121 will be made available for eligible CDBG purposes when the loan is repaid. Also, if liens are recorded, HUD's more than \$4.2 million interest would be protected, thus ensuring that the funds would be available for other CDBG-eligible activities.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



CITY OF ELIZABETH, NEW JERSEY
DEPARTMENT OF PLANNING AND COMMUNITY DEVELOPMENT
OFFICE OF THE DIRECTOR
50 Winfield Scott Plaza, Elizabeth, N.J. 07201-2462
PHONE: (908) 820-4072 FAX: (908) 820-3776

WILLIAM REYES, JR.
Director

J. CHRISTIAN BOLLWAGE
Mayor

July 17, 2012

Edgar Moore, Regional Inspector General for Audit
US Department of Housing and Urban Development
Office of the Inspector General
26 Federal Plaza, Room 3430
New York, New York 10278-0068

Re: HUD-OIG Audit Report

Dear Mr. Moore:

The City of Elizabeth ("Grantee") has recently been subject to a review and audit of the Community Development Block Grant ("CDBG") Program by HUD's Office of Inspector General. A draft Audit Report was furnished to the Grantee on June 26, 2012 for review and comment.

Please be aware that the Grantee is sincerely appreciative and grateful of the exhaustive review conducted by member(s) of HUD-OIG with respect to HUD rules and regulations and general grant compliance relative to the CDBG Program. As directed, the Grantee has formulated responses based upon the Audit Report's recommendations to follow and provided supporting documentation where applicable.

The Grantee respectfully requests that such responses shall be considered further to resolve any outstanding issues that may have been cited in the draft audit report. Although the Grantee is in general agreement with the HUD OIG's findings and general overall commentary, in certain documented instances, the Grantee has every intention to offer a viable explanation to justify the Grantee's position. In other instances, the Grantee shall reassert its position that the Program has been the subject of a constant review and audit internally and the Grantee has made measurable progress over the past several years allowing the Program to flourish while being compliant with HUD rules and regulation and Program requirements.

The Grantee remains committed to successfully administering the CDBG Program. To this end the Grantee has and will continue to devote its resources to ensure adherence to HUD rules and regulations.

The Grantee looks forward to continued professional relations with HUD and its various regulatory agencies. Ultimately the Grantee shares a similar directive to ensure that federal dollars awarded are utilized for qualified usages for the betterment of the community at-large to promote social awareness and equity.

Thank you again for your staff's due diligence with the review, audit, preparation of the draft audit report and the forthcoming official HUD audit report.

If you have any questions, feel free to contact me.

Respectfully,


William Reyes
Director
Planning and Community Development

Ref to OIG Evaluation

Auditee Comments

The City of Elizabeth (“Grantee”)

Prepared comments based upon recommendations of the HUD-OIG Audit.

Comment 1

Comment to 1A:

The Grantee acknowledges that the microenterprise loan in question was deemed ineligible and immediately upon discovery requested that the Corporation reimburse the CDBG Program in the amount of \$20,000. Documentation has been provided to HUD-OIG previously substantiating that the funds were reimbursed and deposited in the CDBG bank account.

Comment 2

Comment to 1B:

The Corporation is negotiating for the return of the money totaling \$150,000, but has not made a final determination to pursue a legal resolution. If an amicable resolution cannot be reached in the next thirty days, then the Corporation shall pursue legal action to collect on the defaulted commercial loan.

Comment 3

Comment to 1C:

The Grantee is in agreement that it erred by charging expenditures to the CDBG Program as a result of a comprehensive reconciliation between the Grantee and the Corporation’s internal records specifically for economic development. Immediately upon discovery, the Grantee reimbursed the CDBG Program in the amount of \$45,000 from a non-federal source. Documentation has been furnished to HUD-OIG in conjunction with the audit. The documentation substantiates that the funds were reimbursed in their entirety and deposited in the grant’s respective bank account. What remains is direction by the HUD local field office for the proper recognition of program income in HUD’s Integrated Disbursement Information System (“IDIS”).

Comment 4

Comment to 1D:

The Grantee has requested from the Corporation that any net profit after the deduction for qualifying incidental costs shall be returned to the Grantee as program income to be in compliance with 24 CFR 570.500(a)(1)(3). The Corporation has requested that these funds are essential in establishing a reserve account to offset any future unforeseen repairs and maintenance for the property that was funded predominantly with federal dollars. In compliance with HUD rules and regulations, the Grantee shall require the sub-recipient to return the funds to the Grantee thus satisfying the program income requirement. Per 2 CFR Part 230, the sub-recipient may be entitled to a “contingency” reserve if legally required by contract. The Grantee shall earmark those funds with the proper approvals of which was the original intended purpose of such funds. Thereby satisfying HUD’s requirements and allowing the landmark building to remain self-sustaining in these dire economic times.

Comment 5

Comment to 1E:

The Grantee has been reimbursed by the Corporation for the said amount of \$15,666 determined by HUD-OIG as disqualified costs. The balance is the sum total of an overpayment of \$2,972 and various miscellaneous ineligible activities totaling \$12,694 concluded by the audit. Documentation was previously forwarded to substantiate the Grantee has satisfied its regulatory requirements.

Comment 6

Comment to 1F:

The Grantee acknowledges that there was an administrative lapse which allowed the Program to be charged prior to receiving the requisite approval for the release of funds related to the potential acquisition of the adjoining property to 244-246 North Broad Street, the two properties collectively were contemplated as the future site for the Corporation to conduct its business operations. The Grantee shall ensure that that the Program shall be charged subsequent to receiving the release of funds per program year. Furthermore, the Grantee shall establish

Ref to OIG Evaluation

Auditee Comments

Comment 6

that there is a direct correlation (delivery costs) between soft costs vs. hard costs for each funded project funded via federal sources. The soft costs shall be legitimately drawn if and only if there is a proportionate share of hard costs drawn. The questioned costs determined for the project is \$144,780 that were expended without performing the requisite environmental review (24 CFR Part 58) as part of a feasibility study, therefore, disqualifying the total allotment.

Comment to 1G:

Comment 7

The Grantee shall utilize the resource manual as a reference and the pertinent federal regulations, 24 CFR 570 and 24 CFR 84 and the applicable Office of Management Bulletin's ("OMB's") for guidance and direction regarding CDBG requirements and cost allowability. Furthermore, the CDBG staff shall continue to contact the HUD local field office for an interpretation of the federal regulations pertaining to the Program. The Grantee will provide its written policy to provide for same.

Comment to 1H:

Comment 8

The Grantee respectfully requests that this recommendation be dismissed due to the aging of the projects. The original audit encompassed PY 2009 and PY 2010 and HUD-OIG expanded upon the audit to accomplish their objective. The Grantee has researched and investigated the HUD rules and regulations pertaining to the CDBG Program regarding the retention and access requirements for records and has determined that the federal standard for records retention is three years and the records request per the HUD audit exceeds that time period requirement. The Grantee is further aware that the Grantee did not "close out" the project(s) in IDIS and for all intents and purposes the project(s) remain active although there has not been an investment of CDBG dollars regarding those two projects since the original budget allocation in PY 2003/2004. Apart from the federal regulations, there should be consideration for the practicality that the projects technically were completed well in advance of the federally mandated three year requirement. Therefore, the Grantee requests a reassessment of the justification of including the project under the purview of the audit since potentially the Grantee may be held accountable for expenditures dating well beyond the scope of the audit in the amount of \$193,774.

Comment to 1I:

Comment 7

The Grantee shall reinforce its existing internal controls requiring that individuals with intimate knowledge of grant compliance and budget status initial and date all vouchers submitted for payment representative of a review confirmation. The sub-recipient's request for payment shall include all supporting documentation to substantiate the claim, including but not limited to, invoices, canceled checks, payroll reports, time sheets and other documentation deemed necessary. The Grantee will provide its written policy to provide for same.

Comment to 2A:

Comment 9

The Grantee agrees that the proper due diligence was not executed at that time and did not request nor receive its fair share of program income ("PI") generated as a result of the disposition of the 3rd Presbyterian Church funded predominantly with CDBG dollars. The Grantee, however, disputes that the sum total calculated by HUD-OIG is an accurate depiction of the amount owing. It is of the Grantee's opinion that \$531,079 is not a true representation of the financial obligation because (a) all sources invested in the property have not been accounted; and (b) the investor equity pertaining to the proceeds of sale is not recognized for purposes of calculating the "fair share" of PI due to the disposition of the asset. Please refer to the exhibit A representing the Grantee's calculation comprehensive of all sources of investments and the equity distribution for the acquisition and restoration of the said property.

As has been discussed during the audit phase, the HUD rules and regulations do not provide for clearly defined guidance for selective financial transactions. The handling of the Grantee's equitable distribution due to the disposition of an asset subsidized by federal dollars is an instance where the statement above applies. The Grantee utilized an equitability factor as a barometer to determine the "fair share" allocation due to the Grantee

Ref to OIG Evaluation

Auditee Comments

Comment 9

as a percentage of proceeds of sale in an attempt to comply with the regulations. It is of the Grantee's opinion that the financial obligation due to the Grantee as the administrator of the CDBG Program equates to \$267,141. Where the Grantee deviates from auditor's evaluation is the material nature of equity upon the PI requirement. Rather than accounting for the equity earned over the life of the various loans and safeguarding the equity applicable to the respective share of the proceeds of sale at closing to benefit the investor, the auditor does not account for the equity and is in essence penalizing the investor for paying down the various loans and building owner equity in the process. The Grantee cannot conceivably rationalize the equity earned by the investor, per the auditor's assessment, having no financial bearing upon the calculation. The auditor's evaluation does not account for all the various sources invested in the development nor identify the full extent of equity for purposes of computing the equitable distribution applied to the proceeds of sale. To reiterate, the auditor's interpretation of the calculation thereof and the components included in the analytical equation to satisfy the PI requirement artificially increases HUD's stake and conversely, reduces the seller's entitlement significantly.

Comment 10

With respect to the 205 First Street project, the Grantee disputes any obligation to reimburse the sum total of \$208,198 due to the disposition of the four parcels of which HUD claims prompted PI. It appears that the project including the financing structure had received prior approval by HUD. Please be aware the funds received by the Housing Authority ("HACE") as a result of the sale remain devoted to a qualifying eligible activity, social services, dedicated to that development. Therefore, it is of the Grantee's opinion that the transaction was completed with HUD approval and that HUD received the full benefit of the financial transaction. The Grantee has furnished the documentary evidence for HUD-OIG review.

Comment to 2B:

Comment 7

The Grantee anticipates that the funds totaling \$131,121 shall be returned subsequent to the publication of the HUD-OIG Audit Report. As determined by the audit, the source of the funds was PI and the loan was extended for predevelopment costs for an affordable housing complex in dire need of rehabilitation and maintenance creating a quality of life issue. The funds are scheduled to be returned by August 2012. There have been a number of delays due to the housing sponsor, the recipient of the loan, attempting to secure and finalize financing. Once the funds are returned, the Grantee shall deposit the said funds in the specific grant bank account and record the proper recognition of program income in IDIS with the assistance of the HUD local field office of whom has been informed of the pending financial transaction.

Comment to 2C:

Comment 11

The Grantee is in agreement that any asset subsidized by federal dollars is required to be productive and generate income. The Grantee has received an appraisal report from the Corporation regarding a fair market value appraisal for the commercial space thus establishing the required rent to be paid satisfying the PI requirement. The rent shall commence the initial month (c. 7/1/2011) the commercial space was occupied by the Corporation to current day. Upon receipt of the rental funds the Grantee shall deposit in the specific grant bank account and the program income shall be recognized in IDIS. Documentation shall be furnished when available.

Comment to 2D:

Comment 7

The Grantee constantly strives to promote internal controls and compliance with program requirements. The CDBG staff has developed a greater understanding of the HUD rules and regulations as a result of the HUD-OIG audit. The relationship between the investment of federal dollars in a development and the subsequent financial ramifications is closely monitored for the potential of recapturing program income. Once PI is received the said funds shall be deposited in the grant bank account and the proper recognition shall be recorded in IDIS increasing the Grantee's line of credit and thus satisfying the CDBG program requirements. The Grantee will provide its written policy to provide for same.

Ref to OIG Evaluation

Auditee Comments

Comment 7

Comment to 2E:

The Grantee shall reinforce the requirement that properties subsidized partially or wholly by federal grants (i.e. CDBG) be subject to an official appraisal by a certified appraiser familiar with the real estate market and price evaluation specifically in the area of interest. The appraisal reports shall serve as the basis for the rent required to be paid to satisfy the PI requirement.

Comment 12

Comment to 3A:

The Grantee has received written acknowledgement by the Corporation that it will execute appropriate note and mortgage documents to effectuate liens on the property to protect the Grantee's investment of CDBG funds. The Grantee acknowledges that the interest in the two properties in question has yet to be recorded. The Grantee is in the process of drafting the legal documents to record liens representative of the total federal dollars invested. Furthermore, the Grantee shall require of the Corporation for all future economic development projects funded with a share of federal dollars to prepare a certification of total project costs at completion. The Report shall serve as the basis for recording liens in order to protect HUD and the Grantee's interest in the event the properties are disposed of at a later date. Mortgages shall be presented for execution within a week's period of time.

Comment 13

Comment to 3B:

The Grantee agrees that the recommended corrective action plan by the monitor be implemented within reasonable parameters. The Grantee has on file risk analysis for programs years 2009 and 2010. The Grantee has on file monitoring reviews for 36 clients for CD 35 and 33 clients for CD 36. Granted the monitoring review was limited to a desk review, but the Grantee's monitoring policy does not require an on-site review of the sub-recipients. The documents in question have been forwarded previously to HUD for review.

Comment 7

Note that the Grantee has determined that the current monitoring policy is not realistic based upon the staff and dedicated resources available to conduct a comprehensive review of each sub-recipient ("sub") awarded per program year. Therefore, in order to more effectively utilize department resources and deliver on-site monitoring of, the Grantee is considering the following revised administrative and monitoring policies:

- Increase the minimum award to \$10,000 per sub-recipient. Thereby, reducing the number of subs per program year.
- Amend monitoring policy to require on-site visits to approximately one third of the total subs per annum. Therefore the full range of funded subs shall be monitored in their entirety over the course of three years based upon a full cycle. This is a viable option because the agencies typically tend to be funded for multiple program years in succession.
- Reduce the monitoring for the Corporation to two on-site visits per annum and perform an extensive programmatic and fiscal monitoring review due to the material nature of the funding and the concentration in economic development.

The Grantee agrees to review its existing policy with regard to the above three items.

In addition, please be aware that the Planning and Community Development Department responsible for administering the CDBG Program made a best efforts attempt to abide by the requirements of the sub-recipient agreement and fiscal monitoring policy, but the department's resources were further exhausted due to the advent of American Recovery & Reinvestment Act ("ARRA"). To avoid an oversimplification on the root cause of the problem, the same departmental resources were utilized in order to administer existing grants and additional funding courtesy of the economic stimulus plan of which directly contributed to the auditor's findings.

Lastly, the chronological time line of the release of funds (circa August/September) with respect to the commencement of the program year (July) further restricted departmental resources since the available months to

Ref to OIG Evaluation

Auditee Comments

Comment 7

perform an adequate monitoring review was delayed due to the lateness of the release of funds hampering efforts to effectively monitor the subs over the course of a shortened program year.

Comment to 3C:

The Corporation administering economic development activities shall be closely monitored and any formal request for a reprogramming/reallocation of funds redirected to a specific project shall be reviewed for administrative compliance. All reprogramming requests require the approval of the Governing Body by virtue of a resolution. The general public shall be informed as to substantial reprogramming/reallocation of funds in advance to ensure compliance with citizen participation requirements.

The Grantee staff attended the Economic Development Toolkit workshop sponsored by the Cloudburst Consulting Group in May of 2012. The presenters of this workshop stated that whenever the Grantee embarks on a major economic development project with the Corporation, the Grantee should meet with HUD officials and the Corporation to ascertain project feasibility, financing needed to bring the project to fruition, discuss HUD guidelines and establish a calendar of events. A clear vision and outline of the project will assure HUD compliance and move the project forward. Hence, the Grantee is looking forward to improving its monitoring standards of the Corporation and working more closely with the HUD field office on upcoming economic development projects.

Exhibit A to Comment to 2A

Analysis of Program Income Generated due to disposition of 3rd Presbyterian Church

Total Investment	Source	Per HUD-01	Equity at Closing
10,000	Cash	10,000	0
75,000	Equity	75,000	0
460,000	CDBG Loan - 1st	383,859	76,141
113,066	EDC Loan - Principal - 2nd	105,606	7,460
100,000	EDC Loan - Principal - 3rd	73,459	26,541
12,000	EDC Loan - Line of Credit - 4th	12,824	(824)
46,000	United Jersey Bank - Principal	0	46,000
\$816,066		\$660,748	\$155,318

Proceeds of sale less equity stake from all sources		
Proceeds of sale per HUD		629,241
Less:		
CDBG Loan - 1st	76,141	
EDC Loan - Principal - 2nd	7,460	
EDC Loan - Principal - 3rd	26,541	
EDC Loan - Line of Credit - 4th	(824)	
United Jersey Bank - Principal	46,000	
Total equity adjustments		155,318
Revised proceeds of sale per Grantee		473,923

Per HUD-OIG Calculation:

$$\text{\$531,103 } \$460,000 / \$545,000 \times \$629,241.12$$

Per the Grantee Calculation:

(Based upon all verifiable sources of funds invested for acquisition and rehabilitation of said property.)

$$\text{\$267,141 } \$460,000 / \$816,066 \times \$473,923$$

Difference between HUD-OIG and Grantee Calculation:

$$\text{\$263,962 } \$531,103 \text{ less } \$267,141$$

OIG Evaluation of Auditee Comments

- Comment 1** City officials agreed that the \$20,000 loan was ineligible and took corrective action to recover the amount of the loan from the City's subrecipient; however, City officials need to show that they have reimbursed the City's CDBG line of credit for the recovery.
- Comment 2** City officials are seeking repayment of the \$150,000; however, City officials need to reimburse the City's CDBG line of credit for the amount of the ineligible loan.
- Comment 3** City officials took corrective action to reimburse the CDBG bank account for the unauthorized use of \$45,000 of CDBG funds; however, they need to show that the City's CDBG line of credit was credited with the recovery.
- Comment 4** City officials agreed to request the subrecipient to return as program income any net funds after incidental costs. In addition, City officials will request HUD's approval to use these funds as a reserve so that the building could be self-sustaining. Nevertheless, City officials need to show HUD that they have reimbursed the City's CDBG line of credit.
- Comment 5** City officials took corrective action to recover from the subrecipient the \$15,666 expended on ineligible costs; however, City officials need to show that they have reimbursed the City's CDBG line of credit for the amount of the recovery.
- Comment 6** City officials acknowledged that \$144,780 was expended before conducting an environmental review as required. Therefore City officials need to reimburse the City's CDBG line of credit for this expenditure.
- Comment 7** City officials' planned actions are responsive to the recommendation.
- Comment 8** City officials requested that this recommendation be dismissed due to the aging of the projects, citing Federal standards that provide for records retention for three years and noting that the costs questioned were incurred before that timeframe and outside the scope of the audit. However, City officials have not yet closed-out this project activity in IDIS, and regulations at 24 Code of Federal regulations Part 570.490 provide that documentation associated with the grant be maintained for three years after close-out. Further, the audit scope was reported as generally covering the period July 1, 2009, through June 30, 2011, and was extended as needed to accomplish our objective. Therefore, if City officials cannot provide supporting documentation for the unsupported \$193,774, the City's CDBG line of credit should be reimbursed for this amount from non-federal funds.
- Comment 9** City officials acknowledge that the City has not recovered its fair share of program income; however, they believe that \$531,079 is not a true representation of the unreported and unremitted program income associated with the disposition

of the subject property because (1) all sources invested in the property have not been accounted, and (2) investor equity earned as a result of repayment of the loans was not considered. Considering these factors, City officials calculated unreported and unremitted program income to be \$267,141.

OIG acknowledges there is merit to these considerations; however, disagrees that the calculation is the most reasonable because other sources invested in the properties were primarily non-CDBG funds that carried annual interest rates at least four times that of the CDBG loan's annual interest rate, and these loans plus the interest due were paid upon disposition of the property. Therefore, allocating program income to these non-CDBG sources may not be reasonable because it does not account for the risk to the CDBG funds by assuming that the CDBG loan and non-CDBG sources carried the same annual rate. Further, the funding sources used to repay the CDBG and non-CDBG sources were not documented in the files; therefore, these documents supporting that investor equity was used to repay the loans needs to be provided.

Therefore, acknowledging the City officials' comment that HUD rules and regulations do not provide for clearly defined guidance for selective financial transactions, we have revised the audit report to reduce the unreported and unremitted program income amount to \$267,141 as proposed by the City officials and reclassify the difference of \$263,938 between that and our original calculation as unsupported program income pending HUD's review of additional documentation to support that the investor's equity was the only source of funds used to repay the CDBG and non-CDBG loans and a determination as to whether program income generated from the disposition should be allocated to the non-CDBG funding sources.

Comment 10 City officials dispute any obligation to classify as program income and reimburse the \$208,198 from the disposition of the 205 First Street project properties because the project and the financing structure had received HUD's approval and the property remains devoted to social services, an eligible activity. While the project did receive approval from the HUD Office of Public Housing as an eligible activity, approval was not obtained from the Office of Community and Development Planning, which may have different requirements for what is an eligible activity. Therefore, we maintain our position that City officials need to reimburse the City's line of credit and record CDBG program income for the \$208,198.

Comment 11 City officials agreed to impose and collect a fair market rent; when received, City officials need to reimburse the City's CDBG line of credit for the rental income.

Comment 12 City officials action taken to draft legal documents to record liens representative of the total Federal dollars invested in the properties is responsive to the recommendation; once recorded, a copy of the liens should be submitted to HUD for review.

Comment 13 City officials stated that the City's monitoring policy did not require on-site review of the subrecipients, and that desk reviews would comply with the policy. OIG review of the City's monitoring policy concluded that desk reviews would not be sufficient to comply with City's subrecipient annual fiscal monitoring policy which was to include an analysis of vouchers and budgets, examination of journal entries and the general ledger, review of relevant bank statements, review of source documentation, and an analysis of internal controls (i.e. checking approval authority and guidelines for controlling expenditures). Therefore, we maintain that City officials did not conduct annual fiscal monitoring of subrecipients as required by the City's monitoring policy.