



Lexington Housing Authority, Lexington, NC

Rental Assistance Demonstration Program

**Office of Audit, Region 4
Atlanta, GA**

**Audit Report Number: 2017-AT-1011
August 21, 2017**



To: Shirley Wong, Acting Director, Public and Indian Housing, 4FPH

//signed//

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

Subject: The Lexington Housing Authority, Lexington, NC, Did Not Administer Its RAD Conversion in Accordance With HUD Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Lexington Housing Authority's Rental Assistance Demonstration Program (RAD) conversion.

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

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG 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 404-331-3369.



Audit Report Number: 2017-AT-1011

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The Lexington Housing Authority, Lexington, NC, Did Not Administer Its RAD Conversion to Accordance With HUD Requirements

Highlights

What We Audited and Why

We audited the Lexington Housing Authority's Rental Assistance Demonstration Program (RAD) conversion. We selected the Authority based on concerns from the U.S. Department of Housing and Urban Development's (HUD) North Carolina State Office of Public Housing and a request from the Housing Authority's Board of Commissioners. Our audit objective was to determine whether the Authority administered its RAD program in accordance with HUD requirements. Specifically, we focused on whether the Authority (1) maintained adequate financial records, (2) completed timely annual audits, (3) established a waiting list, and (4) ensured tenants were properly certified.

What We Found

The Authority did not maintain auditable books and records, complete timely annual audits, properly establish waiting lists, and ensure that tenants were certified and eligible for project-based voucher assistance. The Authority's prior administration disregarded the established guidelines for maintaining auditable records and performing tenants' recertifications for its RAD units. As a result, the Authority disbursed more than \$2.7 million that was not properly supported and spent more than \$5,900 on improper RAD project based voucher assistance.

What We Recommend

We recommend that the Director of HUD's Greensboro Office of Public and Indian Housing require the Authority to (1) provide documentation for costs or repay more than \$2.7 million from non-Federal funds, (2) ensure that the Authority completes all outstanding annual audits, (3) repay from non-Federal funds the \$5,912 in ineligible RAD rehabilitation assistance expenditures, (4) develop and implement adequate procedures to ensure that its books and records are properly maintained, and (5) properly certify all tenants and reimburse any overages paid.

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Background and Objectives

The Lexington Housing Authority was established in January 1962 in accordance with State of North Carolina and Federal law. The Authority is responsible for administering 512 housing choice vouchers and receives funding for Housing Opportunities for Persons With AIDS. Prior to the Rental Assistance Demonstration Program (RAD), the Authority oversaw two public housing developments. The Authority is administering the funds for the two RAD project-based voucher properties. The Authority's five-member board of commissioners, appointed by the mayor of Lexington, oversees the direction of the Authority. In addition, the board of commissioners is responsible for hiring the Authority's executive director to manage daily operations and the Authority's annual operating budget.

The Rental Assistance Demonstration Program was authorized in fiscal year 2012 to preserve and improve public housing properties and to address a \$26 billion nationwide backlog of deferred maintenance. RAD's purpose is to provide an opportunity to test the conversion of public housing and other U.S. Department of Housing and Urban Development (HUD)-assisted properties to long-term, project-based Section 8 rental assistance units to achieve certain goals, including the preservation and improvement of these properties. This conversion is accomplished through enabling access by public housing agencies to private debt and equity, addressing immediate and long-term capital needs. RAD has two components. The first component allows the conversion of public housing and moderate rehabilitation properties to long-term, project-based Section 8 rental assistance contracts. The second component allows rent supplement, rental assistance payment, and moderate rehabilitation properties to convert tenant protection vouchers to project-based assistance at the end of the contract. The Authority executed housing assistance payments contracts and converted its entire public housing portfolio of 268 units under the first component of RAD to long-term, project-based Section 8 rental assistance units in November 2014. The Authority's converted RAD project-based units consist of 138 units for Terrace Lane and 130 units for Southside Village.

The Authority used its nonprofit organization, Haven Redevelopment Group, Inc., to create the two RAD entities for the RAD conversion. The nonprofit was created May 2, 2011, as the Lexington Housing Redevelopment Corporation, Inc., and the name was changed before the RAD conversion on March 26, 2014. The Haven Redevelopment Group's purpose was to enable persons of low and moderate income in Lexington, NC, to live in safe, decent, and affordable housing and to engage in programs and activities that would promote community economic development within the Lexington and Davidson County. It also had an ownership stake in the Authority's two RAD developments (Terrace Lane and Southside Village).

The Communities Group (TCG) was the developer for the RAD program. It assisted in the planning, application process, codevelopment, and financing of the projects. Once the Authority was accepted into the RAD program, TCG hired the architect, surveyor, contractor, and other parties needed to close the conversion. Once the contractor began work, TCG oversaw the renovation process. TCG is the managing general partner in the limited partnerships of the two

properties. Community Management Corporation handles the property management for Terrace Lane and Southside Village.

Our audit objective was to determine whether the Authority administered its RAD program in accordance with HUD requirements. Specifically, we focused on whether the Authority (1) maintained adequate financial records, (2) completed timely annual audits, (3) established a waiting list, and (4) ensured tenants were properly certified.

Results of Audit

Finding: The Authority Did Not Administer Its RAD Conversion in Accordance With HUD Requirements

The Authority did not maintain auditable books and records, complete annual audits in a timely manner, properly establish waiting lists, and ensure that tenants were certified and eligible for RAD project-based voucher assistance. These conditions occurred because the Authority's prior administration disregarded the established guidelines for maintaining auditable financial records, establishing waiting lists, and maintaining documentation for performing tenants' recertifications for its RAD units. As a result, the Authority disbursed more than \$2.7 million that was not properly supported and spent more than \$5,900 on improper RAD rehabilitation assistance.

Financial Records Were Not Auditable and Supportable

The Authority did not maintain books and records that were auditable and supportable. We reviewed the general ledger for fiscal year 2015 and determined that the Authority comingled its funds without supporting documentation, which resulted in the funds not being identified by funding type. The former executive director signed the consolidated annual contributions contract¹, which states the Authority will maintain books and records identifying the source and use of its funds.

The Authority loaned the RAD developments \$990,000 from its capital funds² at initial closing. This type of transaction is permitted by HUD regulations but only if the accounting system can track the sources and uses of funds in sufficient detail to maintain an adequate audit trail in accordance with the annual contributions contract. When funds are pooled, the annual contributions contract prohibits the Authority from withdrawing more funds from the pool than it has deposited. Although the general ledger showed that funds were paid, there was no documentation to support whether the \$990,000 was paid with capital funds. The loan documents showed that the Authority would loan the developments \$1 million; however, only \$990,000 was paid. The remaining \$10,000 was to be paid to cover any hard rehabilitation costs for the daycare facility at Southside Village during the renovation process. Because of the comingling of funds, the general ledger did not show a single \$10,000 payment to the development. Neither the former executive director nor the former fee accountant tracked the Federal funds in the general ledger as required by the consolidated annual contributions contract, part A, sections 9(C) and 10(C).³ As a result, HUD could not be assured the \$990,000 was properly paid to the RAD developments.

¹ The consolidated annual contributions contract is between HUD and the Authority.

² Office of Public and Indian Housing (PIH) Notice 2012-32 states that public housing agencies are permitted under the demonstration to use public housing funding, including operating reserves and unobligated capital funds, as an additional source of capital to support conversion.

³ Section 9C stated that the Authority shall maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific

The Authority also did not track the predevelopment fees. It provided a spreadsheet from an outside source, stating that more than \$300,000 was spent on predevelopment costs. The interim director did not know whether the Authority or the outside entity spent the funds. Due to the lack of auditable records, we were unable to determine whether the expenses were incurred. Office of Public and Indian Housing (PIH) Notice 2012-32, section 1.5 A, states that a public housing agency is not permitted to spend more than \$100,000 in public housing program funds for predevelopment fees unless the agency has received HUD's approval. HUD did not give the Authority a waiver to expend more than the \$100,000.

In addition, as stated in PIH Notice 2012-32, section 1.5 A, a public housing agency may not use public housing funds following conversion. The Authority's conversion date was November 2014. Without a proper accounting of the Authority's funds, we could not be certain whether it used public housing funds to pay Terrace Lane, LP, and Southside Village, LP, on December 3, 2014, after the conversion.

Further, the Authority was not able to document that all Federal funds⁴ were used for eligible and reasonable purposes. We traced the interfund transfers—using the general ledger and journal vouchers—to the general fund from the previous administration and determined that the transfers were from different bank accounts. However, we were unable to determine how the amounts were derived. Without a clear determination of the funding source, there was no way to tell whether the Authority used the funds appropriately.

Annual Audits Were Not Completed in a Timely Manner

The Authority had not completed an annual audit since fiscal year 2014. Under Office of Management and Budget (OMB) Circular A-133,⁵ subpart B, section 200, non-Federal entities that spend \$500,000 or more in Federal funds are required to have an independent audit performed. The certified public accountant informed HUD on March 21, 2016, that he could not complete the required audits because the former executive director did not provide the documentation needed for his reviews. In May 2016, HUD requested that the interim executive director complete the required audits. However, the audits were not completed before the interim director left the Authority. As of June 16, 2017, the Authority's request for proposal for the annual audits closed.

A Waiting List Was Not Established

The Authority's waiting lists were not properly established and followed after the RAD conversion. The Authority properly included the waiting list occupancy requirements in its RAD administrative plan. It also included descriptions to establish the waiting lists, the transition to project-based vouchers, and the selection methods. However, the former executive director

program regulation and requirement. Section 10 C stated the Authority shall not withdraw any of the funds or accounts authorized under this section amounts for the projects under the ACC, or for the other projects or enterprises, in excess of the amount then on deposit in respect thereto.

⁴ The Federal funds included Housing Opportunities for Persons With AIDS, operating funds from public housing, capital funds from public housing, and Housing Choice Voucher program funds.

⁵ OMB Circular A-133 was moved to 2 CFR Part 200, subpart F, on December 26, 2014, effective as of the Authority's 2015 fiscal year. The threshold amount increased from \$500,000 to \$750,000, based on the change from OMB Circular A-133 to 2 CFR Part 200.

disregarded the Authority's administrative plan requirements for establishing, implementing and following the waiting lists.

We identified seven tenants who moved from the Southside Village property to the Terrace Lane property, who were not on the waiting list and were not recertified when moving into the new property as required by the Authority's administrative plan.⁶

These seven tenants were Authority residents before the RAD conversion. The seven tenants were moved from Southside Village to Terrace Lane in violation of HUD requirements. PIH Notice 2012-32, section 1.6.D.4, states that the project-specific waiting lists that existed at the time of conversion were required to be used in the RAD conversion. Additionally, the management agent for Southside Village and Terrace Lane did not operate the projects as two separate project based voucher sites, as required by the Authority's annual plan, attachment 5A. Instead, property managers from each property would pass tenants back and forth without regard to the waiting lists or recertification requirements. The seven tenants should have been placed at the bottom of the Terrace Lanes waiting list, instead of being put at the top of the list and placed into the next available unit.

We also identified a tenant who moved into Terrace Lane without proper certification and ahead of two others on the waiting list. This new tenant was not on the waiting list and not a former Authority resident. The tenant was the son of the Community Management Corporation property manager for Southside Village. New tenants should have been considered third priority on the waiting list. First priority would have been prior housing authority residents and second would have been housing choice voucher holders. The tenant was not certified for a RAD project-based voucher and bypassed two other tenants when he moved into Terrace Lane on March 2, 2016. One of the bypassed tenants moved into a unit later in March 2016. However, the other bypassed tenant was disabled and remained on the waiting list as of February 2017. The unit, which the family member was placed, would have met the bypassed tenant's special needs.

The property manager's son applied in October 2015 to move into Southside Village. However, he was not properly certified, and in February 2016, management agent officials directed the Authority's staff to move him into Terrace Lane ahead of others on the waiting list. The property manager for Terrace Lane informed us that the management agent's regional manager and the property manager for Southside Village directed her to move the son into Terrace Lane, knowingly ahead of others. She stated that the regional manager and Southside Village manager stated that it would be best to move the tenant into Terrace Lane and not Southside Village because they thought it would be less likely to be discovered that the tenant was the son of the property manager at Southside Village. As a result, HUD paid \$5,912 in unallowable housing

⁶ Attachment 5A Substantial Deviations and Significant Amendment or Modification RAD Initiative of the administrative plan states all 268 public housing units are being converted to two separate properties for project based vouchers and will change from authority wide wait list to project based wait lists. Attachment 5 also states that changes in policies that govern eligibility, admission, selection and occupancy of the units post-conversion are in line with project based vouchers. Chapter 24, section C.1.a of the administrative plan states a separate site-based waiting list will be used for each Housing Assistance Payments contract. Chapter 24, section D.1 states that the Authority will screen admissions pursuant to Chapter 3. Chapter 3, section F of the administrative plan states the Authority will determine tenant eligibility to participate in the program and section G.1.a states that applicants shall be selected in order of date and time of the initial application.

assistance payments for the property manager's son from March 2, 2016, through February 1, 2017.

The Authority Did Not Certify Tenants

Neither the Authority nor the property management agent certified new tenants or former Authority residents after the RAD conversion in January 2015. Instead, the property management agent performed low-income tax credit certifications. However, those certifications did not fulfill the recertification requirements for the RAD project-based vouchers. The former executive director signed the housing assistance payments contract stating that the Authority would determine tenant eligibility. The Authority did not have tenant files and monthly housing assistance payment registers. Without the registers, the Authority could not identify the tenants, support the monthly payments, and adequately calculate the housing assistance payments. The Authority's housing choice voucher specialist told us that the housing assistance payments and tenant rents remained at the same amounts as before the RAD conversion. As a result, the more than \$2 million in housing assistance payments paid from January 1, 2015, through December 31, 2016, was insufficiently supported, along with the associated administrative fees earned for the tenants.

In December 2016, the Authority entered into a contract to procure management services to assess and manage the Authority. Under the guidance of the contractor, the Authority began documenting tenant files and certifying tenants for the RAD. The Authority was unable to apply its February 2017 certification determinations to past periods because it lacked the housing assistance payment registers from those periods, which would have been needed to identify the tenants receiving housing assistance payments during 2015 and 2016.

In addition, the Authority received and paid the owners more than \$669,000 for vacant units during the renovations for all of 2015 for Terrace Lane apartments and from January 2015 through May 2016 for Southside Village. The Authority was unable to provide monthly housing assistance payment registers from January 2015 through December 2016, which would have been needed to identify the vacant units to support the monthly vacancy payments received each month. The Authority did not maintain records regarding the renovations of the units, including the dates on which the units were completed, the project was cleared for leasing, or tenants were placed into units. The housing assistance payments contract stated that a vacant unit was to receive \$461 per month until the renovations were complete. The number of vacancies should have declined over time as the units were renovated and tenants were placed. Also, since the Authority received a flat amount per unit during renovations, it would be expected that the amount requested should have varied from month to month. For example, the Authority received the same monthly amount for the vacant units from July 2015 through May 2016, or 11 months, for both Terrace Lane (\$30,892) and Southside (\$19,365). As a result, it paid the owners more than \$669,000 for monthly RAD rehabilitation assistance for vacant units in 2015 and 2016, which was not adequately supported.

Conclusion

The Authority did not follow HUD requirements. This condition occurred because the prior administration disregarded established guidelines for maintaining auditable financial records, completing annual audits timely, establishing waiting lists, and performing recertifications. The

Authority could not assure HUD that its RAD transactions were appropriate because it disbursed more than \$2.7 million that was not properly supported and spent more than \$5,900 on improper RAD project based assistance.

Recommendations

We recommend that the Director of the Greensboro Office of Public and Indian Housing require the Authority to

- 1A. Provide adequate supporting documentation for the amount of Public Housing Capital Fund loan to verify the loan source. If another source of Federal funds is determined, repay the amount to the appropriate program from non-Federal funds.
- 1B. Provide support showing the amount of predevelopment fees paid. If it is over the allowable amount, that portion should be repaid to the project-based voucher program from non-Federal funds.
- 1C. Provide support showing the source and use of funds paid to the Terrace Lane, LP, and Southside Village, LP, after the RAD conversion or repay the project-based voucher program from non-Federal funds.
- 1D. Develop and implement procedures to ensure that it maintains books and records that provide the source and uses of all Federal funds.
- 1E. Ensure that the Authority completes all outstanding annual audits.
- 1F. Enter into a repayment agreement with Community Management Corporation for the improper housing assistance payments of \$5,912 to be repaid to the project-based voucher program or repay the project-based voucher program from non-Federal funds.
- 1G. Establish, maintain, and follow a waiting list for each project individually.
- 1H. Provide adequate supporting documentation for the \$2,075,314 paid for housing assistance payments for tenant rents for 2015 and 2016 and the associated administrative fees earned or repay the project-based voucher program from non-Federal funds.
- 1I. Properly certify all tenants and reimburse any overages paid and associated administrative fees for tenants housed after January 1, 2017, to the project-based voucher program from non-Federal funds.
- 1J. Provide adequate supporting documentation for \$669,938 in monthly RAD rehabilitation assistance it received for vacant units during the period of construction or repay the project-based voucher program from non-Federal funds.
- 1K. Develop and implement procedures for following project-based voucher requirements for tenant recertifications as project-based voucher tenants at Terrace Lane and Southside Village, and ensure they comply with the Housing Choice Voucher regulations.

We recommend that the Director of the Greensboro Office of Public and Indian Housing

- 1L. Determine whether the households residing in the Authority's project-based voucher units, that bypassed others on the wait lists, received housing in accordance with the program's requirements and if not, consider a referral to HUD's Office of Fair Housing and Equal Opportunity.

Scope and Methodology

We performed our onsite audit work between October 2016 and May 2017 at the Authority's office located at 1 Jamaica Way, Lexington, NC, and our offices in Greensboro, NC, and Atlanta, GA. Our audit period was July 1, 2013, to December 31, 2016. We expanded the audit period as needed to accomplish our objective.

To accomplish our audit objective, we

- Reviewed and obtained the Authority's policies and procedures, relevant laws, and regulations.
- Reviewed the Authority's RAD application and financing sources.
- Reviewed the Authority's financial records, including account listings, general account history, and journal vouchers.
- Reviewed bank statements, annual audited financial statements for fiscal years 2013 and 2014, executed agreements, annual contributions and housing assistance payments contracts, tenant files, and the Authority's nonprofit's bank statements and general ledgers.
- Interviewed HUD's public housing program staff, the Authority's employees, its current and former board members, and current and former Community Management Corporation employees.

The Authority did not have tenant files for 2015 and 2016 to support the more than \$2 million in housing subsidy payments on behalf of its tenants. Therefore, we interviewed Authority employees and property managers and determined that the Authority did not certify any of the tenants for project-based voucher assistance. Using a random number generator, we selected 30 residents, 15 for each property, representing about 11 percent, and reviewed tenant files to determine whether the Authority had certified the tenants in accordance with HUD requirements. We did not use a statistical sample because the Authority was not able to provide a universe for all tenant payments in our audit period. Therefore, results from this review cannot be projected.

Computer-processed data generated by the Authority were not used to support our audit findings and conclusions. Instead, our conclusions were based on the supporting documentation obtained during the audit, including but not limited to written agreements, tenant eligibility files, interviews, property management data, and property site visits.

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.

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:

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

We assessed the relevant controls identified above.

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

Significant Deficiencies

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

- The Authority did not maintain auditable books and records, complete timely annual audits, properly establish waiting lists, and ensure that tenants were certified and eligible for RAD project-based voucher assistance (finding)

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/	Unsupported 2/
1F	\$5,912	
1H		\$2,075,314
1J		669,938
Totals	5,912	2,745,252


- 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.

Appendix B


Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments



Darbah Skaf/Executive Director
Lexington Housing Authority
1 Jamaica Dr. Lexington, NC 27292
(Office) 336.249.8936
(Fax) 336.249.9353



July 24, 2017

Ms. Nikita Irons, CGAP, CFE
Regional Inspector General for Audit
U.S. Dept. of HUD, Office of Inspector General
Richard B. Russell Federal Building
75 Ted Turner Drive, SW Room 330
Atlanta, GA 30303

RE: Lexington Housing Authority Response to the HUD Office of OIG

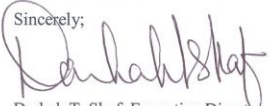
Dear Ms. Irons;

On May 12, 2016, Ms. Fuller, Chairperson of the LHA Board of Commissioners contacted the Greensboro Office of Public Housing regarding the termination of the then Executive Director and noted significant issues and concerns of the RAD deal. Ms. Fuller requested immediate assistance from the Office of Public Housing.

On November 16, 2016; the GOPH issued benchmarks to be met by the Board of Lexington Housing Authority (LHA) by the end of April 2017. All of the benchmarks have been completed and the PHA has a management score of over 96.3%. The LHA has already put forth mechanisms and has corrected several of the findings noted in the OIG report and will continue to work with the GOPH to facilitate the process. We intend to use the OIG report as a road map as we move forward.

The Lexington Housing Authority does business in accordance with the Federal Fair Housing Law and the Fair Housing Amended Act of 1988.

Thank you for the information you have provided and LHA is committed to the citizens of Lexington and Davidson County, North Carolina in providing safe, decent, sanitary and affordable housing and to improve their quality of life.

Sincerely;

Darbah T. Skaf, Executive Director

Comment 1

OIG Evaluation of Auditee Comments

Comment 1 The Authority stated that they have put forth mechanisms and have corrected several of the findings noted in the OIG report and will continue to work with the Greensboro Office of Public Housing to facilitate the process.

We acknowledge that the Authority has begun taking action. The Authority must continue working with HUD to provide adequate supporting documentation, and ensure that all corrective measures are completed and effective to address the recommendations during the audit resolution process.