



Issue Date August 7, 2008
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Audit Report Number 2008-AT-1011
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TO: Gary Dimmick, Director, Office of Community Planning and Development, 4FD

*James D. McKay*

FROM: James D. McKay, Regional Inspector General for Audit, 4AGA

SUBJECT: The City of Durham, North Carolina Did Not Comply with HOME Investment Partnerships Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the City of Durham (City), North Carolina's HOME Investment Partnerships (HOME) program as part of our annual audit plan. Our audit objectives were to determine whether the City complied with U.S. Department of Housing and Urban Development (HUD) requirements for monitoring HOME subrecipients and recording and using HOME program income.

### **What We Found**

The City did not always perform required monitoring reviews or provide adequate evidence that monitoring reviews were performed. This condition occurred because the City lacked sufficient written procedures to ensure that monitoring was performed and adequately documented. As a result, the City and HUD lacked assurance that HOME activities were conducted in accordance with the requirements or that the intended program benefits were realized.

The City incorrectly used HOME entitlement funds when program income funds were available for use. Also, it did not always make the required program income entries in HUD's Integrated Disbursement and Information System. This

condition occurred because the City had not implemented policies and procedures adequate to ensure that program income was recorded and used as required by HUD. As a result, the City's reporting to HUD was incorrect, and it unnecessarily drew down \$158,223 to its local HOME Investment Trust Fund account.

### **What We Recommend**

We recommend that HUD require the City to establish and implement effective written policies and procedures for monitoring HOME activities and reporting and using program income. We also recommend that HUD require the City to repay interest earned on program income that was not reported in a timely manner and used for HOME activities. In addition, we recommend that HUD require the City to establish the eligibility of funds disbursed for tenant-based rental activities, recalculate tenant rents and refund any overcharged tenants, and reimburse the HOME program for any payments determined to be ineligible.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided the draft report to the City on June 19, 2008, and discussed the findings with City officials at an exit conference on July 1, 2008. The City provided its written comments on July 2, 2008. The City agreed with the findings and recommendations.

The complete text of the City's response can be found in appendix B of this report.

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## BACKGROUND AND OBJECTIVES

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HUD has designated the City of Durham (City) a participating jurisdiction eligible to receive annual Office of Community Planning and Development funding. HUD awarded the City \$1.3 million in HOME Investment Partnerships (HOME) funding for fiscal year 2006 and \$1.2 million for fiscal year 2007. The City is governed by a mayor and a seven-member city council. A City Manager appointed by the City Council oversees the day-to-day functions of the city. The City administers the HOME program through its Department of Community Development. A director manages the daily operations of the department, which maintains its records at 401 Lakewood Avenue, Durham, North Carolina.

The HOME program was created by Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended, and is regulated by 24 CFR [*Code of Federal Regulations*] Part 92. HOME funds are awarded annually as formula grants to participating jurisdictions. Eligible uses of these funds include homeownership downpayment, tenant-based assistance, housing rehabilitation, assistance to homebuyers, and new construction of housing. HOME funding may also be used for site acquisition, site improvements, demolition, relocation, and other necessary and reasonable activities related to the development of nonluxury housing. All housing developed with HOME funds must serve low and very low-income families.

Our audit objectives were to determine whether the City complied with U.S. Department of Housing and Urban Development (HUD) requirements for monitoring HOME subrecipients and recording and using HOME program income.

## RESULTS OF AUDIT

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### Finding 1: The City Did Not Properly Monitor HOME Subrecipients

The City did not always perform required monitoring reviews or provide adequate evidence that monitoring reviews were performed. This condition occurred because the City lacked sufficient written procedures to ensure that the required monitoring was performed and adequately documented. As a result, the City and HUD lacked assurance that HOME activities were conducted in accordance with the requirements or that intended program benefits were realized.

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#### **Monitoring Not Performed or Adequately Documented**

The City contracted with subrecipients to establish and administer some of its HOME activities. We reviewed five activities performed by four subrecipients and found that the City had not performed the required monitoring for three subrecipients performing four activities on behalf of the City. The regulations at 24 CFR 92.504(a) hold the City responsible for managing the day-to-day operation of its HOME program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate action when performance problems arise. The use of subrecipients does not relieve the City of this responsibility. In addition, the City must monitor the performance of each subrecipient annually.

The following sections describe the monitoring deficiencies associated with the different types of HOME activities performed by subrecipients on behalf of the City.

#### Tenant Based-Rental Assistance

Although the City had contracted with The Durham Center to provide tenant-based rental assistance since 2004, the City's files provided no evidence that the City had performed monitoring. When we brought this to the attention of City staff, they provided a copy of a review checklist, which was largely blank. It did not show the entity reviewed, the date, or other necessary information. In addition, the conclusions reached were inadequate or illegible.

The project had been allocated a total of \$200,000 since 2004. As of April 2008, the City had disbursed \$99,831 and was withholding the remaining funds until the subrecipient could provide support for funds it had requested. We reviewed all 17 tenant files for this project and detected a number of deficiencies, which could have been detected and corrected if the City had monitored the project as required. For example, file documentation did not in some cases contain adequate evidence that the tenant's

- Family composition had been considered in calculating the tenant's income, rent, and the housing assistance payments;
- Disability status was adequately supported;
- Disability status had been considered in calculating the tenant's income, rent, and housing assistance payments; and
- Zero-income status was adequately supported

and that

- Rents were not excessive,
- Utility allowances were supported, and
- Housing quality control inspections were performed as required.

In addition, there were indications in 10 of 17 files reviewed suggesting that tenants were charged excessive rents. This condition occurred because the subrecipient appeared not to have made the mandatory deductions (24 CFR 5.611) from incomes for disabled tenants, elderly tenants, or tenants with dependents. The City's lack of written procedures for providing guidance to staff responsible for monitoring subrecipients likely resulted in its inability to detect these deficiencies.

#### Substantial Rehabilitation and New Construction

The Triangle Residential Options for Substance Abusers received HOME funding in the form of two loans for \$54,780 each during March and April of 2006. The loans provided permanent financing for the substantial rehabilitation of two duplexes. Our review of the projects' files showed no evidence of monitoring, although the projects had been complete since November 2006, about 17 months before our review. City staff confirmed that they had not monitored the project, and the City employee responsible for monitoring the project was unaware that the project was complete and was overdue for monitoring.

Housing for New Hope received a \$140,155 HOME grant to finance 25 percent of the costs for construction of a 10-unit special needs rental housing project in January of 2006. As with the substantial rehabilitation project, the City had not performed monitoring, although the building had been certified for occupancy since December 13, 2006, about 16 months before our review. Again, the City employee responsible for monitoring was unaware that the project had been completed and was overdue for monitoring.

The City lacked sufficient written procedures for ensuring that completed projects were monitored as required. After a project was complete and certified for occupancy, the responsible project manager was supposed to alert the employee responsible for monitoring, who would then add the project to the monitoring schedule. For these projects, the informal procedures did not work, and there were no controls to detect or correct the oversight. The breakdown in communication between the project manager and the employee responsible for

monitoring eliminated the only method by which monitoring would have been scheduled and performed.

Since these projects had not been monitored, the City could not assure HUD that program requirements such as eligibility of tenants, accurate rent calculations, and compliance with housing quality standards had been met. After our review, the City monitored the subrecipients. For the substantial rehabilitation project, the City found that the tenants were within income limits, and the units passed inspection. For the new construction project, the City found that four present or former tenants were not within income limits.

## **Conclusion**

The City did not conduct the required monitoring of some HOME subrecipients because it did not have effective written policies and procedures. Without such monitoring, the City and HUD lacked assurance that all HOME projects were established and completed in compliance with the requirements and that the intended program benefits were realized.

## **Recommendations**

We recommend that the Director of Community Planning and Development, HUD North Carolina State Office, require the City to

- 1A. Establish and implement effective written monitoring policies and procedures to ensure that it effectively performs and documents required HOME program monitoring to ensure that the remaining \$100,169 for the tenant-based rental assistance project will be put to better use.
- 1B. Provide the HUD field office with adequate supporting documentation relating to the \$99,831 in HOME funds disbursed for tenant-based rental assistance. Any amounts determined to be ineligible should be reimbursed to the HOME program from nonfederal funds.
- 1C. Recalculate tenant rents and return any overcharges to the appropriate tenants participating in the tenant-based rental assistance project.

## Finding 2: The City Did Not Properly Record or Use Program Income

The City did not make the required program income entries in HUD's Integrated Disbursement and Information System (system) and incorrectly used HOME entitlement funds when program income funds were available for use. This condition occurred because the City had not implemented policies and procedures adequate to ensure that program income was recorded and used as required by HUD. As a result, the City's reporting to HUD was incorrect, and it unnecessarily drew down \$158,223 to its local HOME Investment Trust Fund account.

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### **Program Income Was Not Correctly Used or Properly Reported**

The City generated program income from homeowners making payments on their homebuyer mortgage assistance loans. The loan servicing company provided a monthly report of loan activity to support the electronic transfer of payments to the City. The City's accounting department analyzed the data provided by the servicing company and recorded the payments in the appropriate program's account. The information was communicated to a Department of Community Development employee, who then entered the program income into HUD's system.

Timely and accurate recognition of program income is important because the regulations require that program income be deposited in the participating jurisdiction's local account (24 CFR 92.503(a)) and disbursed before additional funds are drawn from the U.S. Treasury account (24 CFR 92.502(c)).

During our audit period, with one exception, the City generally properly recorded program income in its accounting system. However, the City did not record \$49,695 in program income for July, August, and September of 2006 in its accounting system or HUD's system until October of 2006. The City earned \$328 in interest on these funds due to the delay. The regulations (24 CFR 92.502(c)) require that interest on funds in the local account not expended within 15 days be remitted to the U.S. Treasury. In addition, HUD Notice 97-09 provides that program income should be reported in HUD's system at reasonable periodic intervals not to exceed 30 days.

For the months of May and June of 2006, the City properly recorded \$158,223 in program income in its accounting system but did not enter the amount into HUD's system. Since these funds were not used for HOME activities as the regulations require, they have continued to earn interest for the City. As of April 2008, the City had earned \$12,944 in interest on these funds.



## **Procedures Need Improvement**

The City's existing written procedures, dated May 2006, were insufficient to ensure program income was accurately and timely reported and expended. The City should evaluate these procedures and make modifications as necessary to provide for better internal control and compliance with HUD's requirements.

## **Recommendations**

We recommend that the Director of Community Planning and Development, HUD North Carolina State Office, require the City to

- 2A. Submit for HUD review and approval a plan for improving controls so that program income will be more consistently recorded, reported, and expended in accordance with HUD's requirements.
- 2B. Repay HUD \$13,272 or the current balance for interest the City earned on program income, which was either not recorded in HUD's system or not recorded in a timely manner.
- 2C. Record \$158,223 in program income in HUD's system and expend the funds for eligible HOME activities before drawing down additional funds.

## SCOPE AND METHODOLOGY

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Our audit objectives were to determine whether the City complied with HUD requirements for monitoring HOME subrecipients and recording and using HOME program income. To accomplish our objectives, we

- Obtained and reviewed relevant HUD regulations and City guidelines,
- Interviewed HUD and City officials,
- Reviewed monitoring reports,
- Reviewed applicable City files and records including general ledgers, and
- Reviewed the City's internal controls related to the administration of its HOME program.

Data in the City's information system was relied upon as a basis for the findings and the reliability of the data was assessed. The data was determined to be sufficiently reliable for the purposes of this audit.

### Finding 1

To achieve our audit objectives with respect to monitoring, we reviewed files for all five activities initiated by four subrecipients on behalf of the City during the audit period. As discussed in the finding, we found that the City did not comply with monitoring requirements for three subrecipients performing four activities. The finding also contains \$100,169 in funds to be put to better use. We calculated the amount by subtracting \$99,831 already disbursed from the \$200,000 awarded the subrecipient for tenant-based rental assistance. These funds will be put to better use if the City establishes effective written monitoring policies and procedures to ensure that monitoring is properly performed and documented and, thus, better assure HUD that the funds have been used for eligible tenants.

### Finding 2

Since the City's HOME program income was derived from one source, we reviewed all program income records for the audit period. We determined that \$158,223 in program income will be put to better use if it is recorded in the system and disbursed for HOME-eligible activities as required instead of drawing down additional HOME funds.

The audit generally covered the period July 1, 2005, through June 30, 2007, but we extended the audit period when necessary to accomplish our objectives. We conducted our fieldwork from October 2007 through April 2008 at the City's offices in Durham, North Carolina.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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

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

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

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## Relevant Internal Controls

We determined the following internal controls were relevant to our audit 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 of resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

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

## Significant Weaknesses

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

- The City did not properly monitor HOME subrecipients. (finding 1).
- The City did not properly record or use program income (finding 2).

## APPENDIXES

### Appendix A

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

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<u>Recommendation number</u>	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	<u>Funds to be put to better use 3/</u>
1A			\$100,169
1B		\$99,831	
2B	\$13,272		
2C			<u>\$158,223</u>
Total	<u>\$13,272</u>	<u>\$99,831</u>	<u>\$258,392</u>

- 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 audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reduction in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if our recommendations are implemented, the remaining \$100,169 for the tenant-based rental assistance project will be spent for eligible tenants, and \$158,223 in program income will be used for eligible HOME activities before drawing down additional funds.

## Appendix B

# AUDITEE COMMENTS



**CITY OF DURHAM**  
*City Manager's Office*  
101 CITY HALL PLAZA | DURHAM, NC 27701  
919.560.4222 | F 919.560.4949  
[www.durhamnc.gov](http://www.durhamnc.gov)

July 1, 2008

Mr. James D. McKay  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Audit, Box 42  
Richard B. Russell Federal Building  
75 Spring Street, SW, Room 330  
Atlanta, GA 30303-3388

**Re: Comments on Draft Audit Report  
City of Durham HOME Program**

Dear Mr. McKay:

Thank you for the opportunity to comment on the draft of your audit report on the City's HOME program. The steps we have taken or will take to correct the identified deficiencies are outlined below.

**Finding 1: The City Did Not Properly Monitor HOME Subrecipients**

Tenant-Based Rental Assistance

We do not dispute any of your observations or conclusions. During the time period that the Durham Center was undertaking the rental assistance program, the Department's compliance officer was absent for an extended period of time and subsequently, left the City. As a result, responsibility for project monitoring was re-assigned to individual project managers. Shortly after the reassignment, the project manager for the Durham Center project was out on medical leave and then resigned shortly after returning from leave.

To ensure that insufficient project monitoring does not re-occur, the Department's written performance standards now include the following:

- Within 30 days of receiving a subrecipient assignment, the project manager must meet with the subrecipient to finalize the project scope, review compliance and reporting requirements and prepare the contract for execution.

*Good Things are Happening in Durham*

- Within 30 days of contract execution, the project manager must conduct a start-up visit with the subrecipient to ensure that all internal processes and procedures are in place and to answer any questions.
- No later than the third quarter of the contract period, the project manager must conduct an onsite monitoring visit.
- Within 30 days of final drawdown and/or contract completion, the project manager must issue a close out letter which speaks to the reconciled expenditure amount and compliance.

Approximately six weeks ago, we met with the staff of the Durham Center to discuss the deficiencies which were noted. Since that time, the Durham Center has been working diligently to obtain all remaining source documentation from its subcontractor in an effort to complete and correct each case file. Progress meetings with our staff are held every other week. Additionally, we prepared and provided the Durham Center with detailed checklists to guide their staff through the qualifying and calculations processes. As missing documentation is obtained, the Department and Durham Center staff will work through each file and re-calculate adjusted household income, tenant rent responsibilities and maximum subsidies and compare those calculations to actual payments for each households.

Because of the nature of the population served by this program, it may not be possible to locate each past participant. In such cases, the file will be documented as to the efforts made to contact/locate the participant to obtain missing or complete information and/or to repay rent overcharges.

Substantial Rehabilitation and New Construction

We acknowledge that rental compliance monitoring was not performed for projects undertaken by Triangle Residential Options for Substance Abusers (TROSAs) and Housing for New Hope within the required twelve-month timeframe following completion. In both instances, failure to place these projects on the rental monitoring schedule was the result of a breakdown in internal communications. To ensure that such instances do not occur again the future, the following written procedure was prepared, distributed to all project managers and filed electronically under the HOME program.

***Written Procedure for Ensuring Set-Up of HOME Rental Projects for Monitoring***

*Upon receipt of the Certificate of Occupancy (CO) for a newly constructed or rehabilitated HOME rental project, the responsible project manager must notify the Associate Director for Housing Production and the Federal Programs Coordinator and provide a copy of the CO to each of them. The Associate Director will then direct the staff member responsible for HOME rental monitoring to add the project to the Departmental schedule for rental monitoring. The Federal Programs Coordinator will conduct periodic reviews of the HOME rental monitoring*

*schedule and monitoring reports to ensure that all projects are monitored within the regulatory timeframes.*

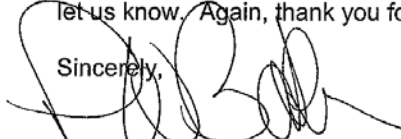
**Finding 2: The City Did Not Properly Record or Use Program Income.**

The City has confirmed that the program income received during FY 2005 and FY 2006 was not transferred from the City's general fund and recorded in the City's accounting system as HOME grant revenue until May and June 2006 totaling \$158,223.00. As of June 27, 2008, the Department of Community Development has recorded \$158,223.00 in IDIS as FY 2006 HOME program income and will draw down these funds prior to entitlements. The City acknowledges that interest earned on the program income needs to be paid to HUD. The amount of interest earned is approximately \$13,275.00 and will be paid to HUD.

Although the Department of Community Development has written procedures in place for Program Income dated May 2006, the Department will update the procedures to improve controls for proper and timely recording, and adherence to compliances with regard to expending and reporting of program income.

Should you have any questions or need additional information, please do not hesitate to let us know. Again, thank you for the opportunity to comment.

Sincerely,

A handwritten signature in black ink, appearing to read 'Patrick W. Baker', written over the word 'Sincerely,'.

Patrick W. Baker  
City Manager