



Issue Date December 16, 2008

Audit Report Number 2009-NY-1005

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

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

SUBJECT: The Township of South Orange Village, New Jersey, Did Not Always Disburse Community Development Block Grant Funds As Per HUD Requirements

HIGHLIGHTS

What We Audited and Why

We audited the Community Development Block Grant (CDBG) program administrated by the Township of South Orange Village (Township), a subgrantee of the Essex County Consortium (County), pertaining to its use of CDBG funds to pay bond proceeds, borrowed from the Essex County Improvement Authority, to construct the South Orange Performing Arts Center, Inc. (Center). We selected the Township because our audit of the County's CDBG operations indicated that the costs incurred for this project were not adequately supported. Our audit objectives were to determine whether the Township (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to the U.S. Department of Housing and Urban Development (HUD) and with applicable rules and regulations, (2) had a financial management system in place to adequately safeguard the funds, and (3) used CDBG funds to meet the national objectives of the program.

What We Found

Except for the disbursement of funds noted below, the Township had an adequate financial management system in place to safeguard CDBG funds and generally used CDBG funds to meet the national objective of eliminating slums and blight.

However, the Township did not always comply with HUD's rules and regulations while disbursing CDBG funds. Specifically, the Township (1) spent \$76,168 for activities related to fundraising and paid \$7,589 in legal fees related to the Township's other general activities, (2) made bond repayments with the annual CDBG funds from the County on behalf of a nonprofit organization without executing a subgrantee agreement, and (3) did not include the required contract provisions in its contract agreements to ensure compliance with federal regulations. Therefore, \$83,757 was disbursed for ineligible activities, and the Township could not ensure that the nonprofit organization and the contractors complied with HUD regulations.

What We Recommend

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the County to require the Township to (1) repay \$83,757 related to the ineligible expenses from nonfederal funds, (2) develop and execute an adequate subgrantee agreement between the Township and the Center, and (3) develop and implement contracts containing all mandatory provisions when using federal funds.

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 a draft report to Township officials on November 14, 2008 and requested their responses by December 4, 2008. We discussed the results of our review during the audit and at an exit conference held on December 4, 2008. Township officials provided their written comments on December 3, 2008. They generally agreed with the draft report findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Community Development Block Grant (CDBG) program provides grants to state and local governments to aid in the development of viable urban communities. To be eligible for funding, every CDBG-funded activity must meet one of the program's three national objectives. Specifically, every activity, except for program administration and planning, must

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

The Township of South Orange Village (Township) is a subgrantee of the Essex County Consortium (County). The Township received approximately \$1.35 million in CDBG funds to cover preconstruction costs related to the South Orange Performing Arts Center (Center) in program year 2001. The Township provided the Center more than \$14 million to pay for the actual construction costs. To finance the project, the Township issued \$5.2 million in bonds through the Essex County Improvement Authority. As the owner of the building, the Center received more than \$350,000 as rental income from July 2006 to June 2007 by leasing five movie theaters to another company and providing a rental service for a live performance hall and a multipurpose room.

The Township annually applied for CDBG grants from the County to pay the bonds. The Township has received approximately \$1.28 million in CDBG grant funds for this debt service since program year 2002.

The files and records pertaining to the preconstruction phase and the partial construction phase of the Center are maintained at the Village Hall located at 101 South Orange Avenue, South Orange, New Jersey.

We audited the Township pertaining to its use of CDBG funds to repay bond proceeds obtained to construct the Center because our audit of the County's CDBG operations indicated that the costs incurred for this project were not adequately supported. Our audit objectives were to determine whether the Township (1) disbursed CDBG funds efficiently and effectively in accordance with its submission to the U.S. Department of Housing and Urban Development (HUD) and with applicable rules and regulations, (2) had a financial management system in place to adequately safeguard the funds, and (3) used CDBG funds to meet the national objectives of the program.

RESULTS OF AUDIT

Finding: The Township Did Not Always Comply with Federal Regulations While Disbursing CDBG Funds

The Township did not always comply with HUD rules and regulations while disbursing CDBG funds. Specifically, it (1) spent \$76,168 on activities related to fundraising and paid \$7,589 for legal fees related to its other general activities, (2) made bond repayments with the annual CDBG funds from the County on behalf of a nonprofit organization without executing a subgrantee agreement, and (3) did not include the required contract provisions in its contract agreements to ensure compliance with federal regulations. These deficiencies were due to Township officials' insufficient knowledge of federal requirements and the County's inadequate monitoring. As a result, \$83,757 in CDBG funds were expended for ineligible activities, and the Township could not ensure that the nonprofit organization and the contractors had complied with HUD regulations.

Ineligible Preconstruction Expenses

Regulations at 24 CFR [*Code of Federal Regulations*] 84.27 indicate that the allowability of costs incurred by state, local, or federally recognized Indian tribal governments is determined in accordance with the provisions of Office of Management and Budget Circular A-87, "Cost Principles for State and Local Governments." Circular A-87, section 17(a), indicates that costs of organized fundraising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions, are unallowable, regardless of the purpose for which the funds will be used. Nevertheless, the Township paid three companies \$76,168 for activities related to fundraising. To be more specific, the Township hired a fundraising company to conduct a feasibility study; hired another fundraising/public relations company to establish fundraising procedures to cultivate the board for the Center, and to campaign for the construction of the Center; and hired an architect to build a model of the proposed arts center for fundraising events.

In addition, the Township submitted billing statements and payment records from its lawyer to the County in the amount of \$21,054 as part of the supporting documentation for its drawdown during the preconstruction phase. However, the bills for \$7,589 included the lawyer's charges for preparing and revising the ordinances and bond anticipation notes related to the Township's other general activities. The other general activities involved purchasing energy-saving light fixtures in various municipal facilities, Village Hall interior renovations, sidewalk and curb repairs, purchase of various vehicles for the Township, computer equipment and upgrades, traffic equipment, a recreation center, purchase of other

real estate for resale, improvements to a water system, etc. This conduct violated the regulations at 24 CFR 570.200 (d), which require that general professional services be related to program execution to be eligible for assistance with CDBG funds. Therefore, the expense of \$7,589, which was not related to the construction of the Center or program execution, is considered an ineligible cost.

These deficiencies were due to Township officials' insufficient knowledge of federal requirements and the County's inadequate monitoring. As a result, \$83,757 in CDBG funds was expended for ineligible activities and should be repaid from nonfederal funds.

Lack of Subrecipient Grant Agreement

The Township could not adequately ensure that the Center, its subrecipient, complied with HUD regulations because it failed to execute a subrecipient agreement, which spells out the terms and regulations to be followed, and the Center was not adequately monitored by the County and/or the Township. Regulations at 24 CFR 570.501(b) provide that the grant recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements, such as determining the adequacy of performance under subrecipient agreements and procurement contracts, and taking appropriate action when performance problem arises.

The Township also did not follow regulations at 24 CFR 570.503(a), which require a written agreement with a subrecipient before disbursing CDBG funds. The Township received CDBG funds from the County and paid more than \$1.3 million in preconstruction costs and more than \$1.2 million in debt service costs¹ for the bond issue that benefited the Center. However, the Township and the County could have difficulty in getting the Center to comply with HUD requirements because the Township did not execute a proper subrecipient agreement with the Center. A properly executed subgrantee agreement would permit HUD and the County to better enforce HUD regulations by holding the subrecipient accountable and properly safeguarding grant funds.

We attribute this deficiency to Township officials' lack of knowledge regarding federal requirements and to the County's inadequate monitoring of the Township, as the County only reviewed the invoices of bond repayments and did not ensure that a proper subrecipient agreement had been executed. As a result, there was little assurance that the Center complied with HUD regulations.

¹ The annual average amount of CDBG funds used for the repayment of the bond is \$214,667 (total amount of CDBG funds disbursed for bond repayment, \$1,288,000, divided by six years).

Insufficient Contract Provisions

The Township did not always comply with regulations at 24 CFR 85.36(i) related to contract provisions. These regulations require that grantee and subgrantee contracts contain the provisions in section (i) and list 13 provisions for a contract. These provisions include legal remedies for breach of contract, termination for cause, equal opportunity requirements, compliance with labor standards, reporting and record retention requirements, compliances with the Clean Air Act and the Clean Water Act, and compliance with the Energy Policy and Conservation Act. However, the contracts executed by the Township did not include all of the applicable provisions.

Only one contract between the Township and the general contractor for the construction of the Center contained most of the required provisions. However, even this contract agreement lacked the mandatory standards and policies relating to energy efficiency. The lack of complete contracts was due to the Township's inadequate controls over procurement. As the result, the Township could not ensure that the contractors would comply with all mandatory federal requirements while disbursing federal funds because the requirements were not included in their contracts.

Conclusions

The Township did not always comply with its submission to HUD and with applicable rules and regulations while disbursing CDBG funds. Accordingly, \$83,757 was disbursed for ineligible activities, and the Township could not ensure that the nonprofit organization and the contractors complied with HUD regulations due to the lack of a subgrantee agreement and insufficient contract provisions. We attribute these deficiencies to the inadequate knowledge of Township's officials regarding federal requirements and inadequate monitoring by the County.

Recommendations

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

- 1A. Request that the Township reimburse \$83,757 (\$76,168+\$7,589) to the County's line of credit from nonfederal funds.
- 1B. Request that the Township develop and execute an adequate subgrantee agreement between the Township and the Center, containing all of the provisions required by HUD regulations. By executing a subgrantee

agreement, we can be assured that the average annual CDBG funding of \$214,667 allocated to repay the bond will be put to better use.

- 1C. Request that the Township develop and implement procedures to ensure that all of its procurement contracts with entities using federal funds include the mandatory contract provisions required by 24 CFR 85.36(i).
- 1D. Conduct periodic monitoring to ensure that the Township is administering its CDBG activities in compliance with HUD requirements.

SCOPE AND METHODOLOGY

The audit focused on determining whether the Township disbursed its CDBG funds in accordance with HUD requirements. To accomplish our objectives, we

- Reviewed relevant federal and New Jersey state regulations;
- Interviewed appropriate personnel of HUD's Office of Community Planning and Development Newark field office;
- Reviewed the County's monitoring review report and independent public accountant audit report for the Township;
- Reviewed the Township's policies, procedures, and practices and interviewed key personnel to obtain an understanding of its administration of the CDBG program;
- Reviewed the Township's annual application package to the CDBG grant and its bond agreement; and
- Reviewed the Township's files and records related to procurement and construction to determine whether the costs were eligible and adequately supported as required by HUD regulations.

We reviewed the mortgage loan agreements between the Township and the Center and the financial summary and independent public accountant report for the Center. We reviewed all of the Township's payments to 13 vendors for the drawdown of more than \$1.3 million during the preconstruction phase to determine whether they were eligible and adequately supported. We also selected seven vendors that charged an aggregate amount which was more than the public bidding threshold amount of \$17,500 to test whether the Township had adequate control over the procurement process in accordance with New Jersey state law. In addition, for the construction phase, we reviewed the Township's procurement process for obtaining the contractor, the construction contract, and all construction payments to the contractor.

The audit generally covered the period June 1, 2003, through May 31, 2007. However, to accomplish our objectives, we extended the audit period back to January 1, 1998, as it relates to the preconstruction phase.

We performed our audit fieldwork from June through August 2008 at the Village Hall in the Township of South Orange Village, New Jersey. We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

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

We assessed the relevant controls identified above.

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

Significant Weakness

Based on our review, we believe the following item is a significant weakness:

- The Township did not have adequate controls over compliance with laws and regulations, as it did not always comply with HUD regulations while disbursing CDBG funds (see finding).

APPENDIXES

Appendix A

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

<u>Recommendation number</u>	<u>Ineligible 1/</u>	<u>Funds to be put to better use 2/</u>
1A	\$83,757	
1B		\$214,667


- 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/ Recommendations that funds be put to better use are estimates of amounts that could be used more effectively and efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures, and any other savings which are specifically identified. In this instance, if the Township implements our recommendation to develop and execute an adequate subgrantee agreement with its subrecipient, the Center, we can be assured that the average annual outlay of \$214,667 in CDBG funds used to repay the bond will be put to better use. This amount represents one year's debt service calculated by taking the annual average amount of CDBG funds used to repay the bonds over the last six years.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

	 <p data-bbox="841 682 1291 718"><i>The Township of South Orange Village</i></p> <p data-bbox="925 718 1201 772">VILLAGE HALL SOUTH ORANGE, NEW JERSEY 07079 (973) 378-7715, ext. 2</p> <p data-bbox="516 865 755 934">John O. Gross, C.P.M., C.M.F.O. Village Administrator Chief Financial Officer Treasurer</p> <p data-bbox="454 1008 625 1029">December 3, 2008</p> <p data-bbox="454 1075 933 1213">Mr. Joseph Vizer Assistant Regional Inspector General for Audit U.S. Department of Housing and Urban Development Newark Area Office One Newark Center Newark, New Jersey 07102</p> <p data-bbox="454 1239 1112 1260">Re: Draft Audit Report - Township of South Orange Village, New Jersey</p> <p data-bbox="454 1285 592 1306">Dear Mr. Vizer:</p> <p data-bbox="454 1333 1323 1375">I am in receipt of the subject audit report and after consultation with local officials, I have prepared comments in response to the following audit findings:</p> <ol data-bbox="454 1396 1323 1585" style="list-style-type: none">1. Disbursed CDBG funds (\$76,168 for fundraising and \$7,589 for legal fees) in a manner not always compliant with HUD rules and regulations.2. Made bond payments with annual CDBG funds from Essex County on behalf of the SOPAC nonprofit organization without executing a subgrantee agreement.3. Did not include required federal contract provisions in the contract documents in order to insure compliance with federal regulations. <p data-bbox="454 1606 1323 1722">We concur with the requirement for repayment of \$83,757 for the identified expenditures; development and execution of an adequate subgrantee agreement by and between the Township and the nonprofit; and, development of future contracts utilizing federal funds so as to include all mandatory provisions of related regulations. In addition, and specific to the three audit findings, we are offering the following comments:</p> <ol data-bbox="454 1743 1323 1795" style="list-style-type: none">1. The project's qualified expenditures for construction of the SOPAC facility by the nonprofit far exceed the amount of funding provided by the County for the project. As a result, we respectfully
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Comment 1

Comment 2

request that the funds alternatively be applied against those qualified expenditures. In the alternative, we request they be returned to the County to be recommitted to cover other eligible project construction costs.

Comment 3

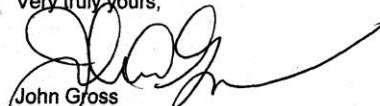
2. Once the audit report is completed, the Township with assistance from the County of Essex will immediately prepare and execute a subrecipient agreement with the SOPAC Board of Directors. It is understood that this agreement will apply to previous and future Community Development funding received by the nonprofit from the Township.

Comment 4

3. The Township will continue to work with Essex County in order to insure future compliance with federal contract regulations. The provisions omitted from the past agreements were an oversight and not intentionally left out of the legal documents.

In conclusion and as noted in your audit draft report, our performance deficiencies were due to Township and County program administration officials' insufficient knowledge of federal requirements. Your consideration of our request for the re-utilization of the reimbursed funds is gratefully acknowledged. We appreciate your guidance in this and future matters.

Very truly yours,



John Gross
Administrator/CFO

The Township of South Orange Village

OIG Evaluation of Auditee Comments

- Comment 1** Auditee officials concurred with the finding.
- Comment 2** Auditee officials stated that the project had additional qualified expenses; therefore, they requested whether the amounts to be refunded could be applied against those qualified expenses, or be recommitted to cover other eligible project construction costs. The questioned costs of \$83,757 were not eligible costs and should be reimbursed to the County's line of credit from nonfederal funds. However, regarding re-applying of any funds repaid, during the audit resolution process the HUD field office may make a determination on the eligibility of any additional costs and /or funding.
- Comment 3** The Auditee's proposed actions are responsive to the finding.
- Comment 4** Auditee officials stated that the omission of the contract provisions was an oversight. The Auditee's proposed corrective actions are responsive to the finding.