



Issue Date December 29, 2009
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Audit Report Number 2010-LA-1004
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TO: William Vasquez, Director, Los Angeles Office of Community Planning and Development, 9DD

*Joan S. Hobbs*

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: Although the County of Riverside Had Sufficient Overall Capacity, It Lacked Necessary Controls To Administer Its Neighborhood Stabilization Program

## **HIGHLIGHTS**

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

We completed a capacity review of the County of Riverside's (County) Neighborhood Stabilization Program (Program). We performed the audit because Housing and Economic Recovery Act of 2008 (HERA) reviews are part of the Office of the Inspector General's (OIG) annual audit plan and the program was identified as high risk. In addition, the County was awarded a significant amount of Program funds.

Our objective was to determine whether the County had sufficient capacity and the necessary controls to manage and administer Program funds provided by HUD under HERA.

### **What We Found**

The County generally had sufficient capacity to administer its allocation of Program funds. It had (1) begun the use of Program funds for eligible activities; (2) written policies and procedures to support its financial activities and Neighborhood Stabilization Homeownership Program; (3) appropriate staffing levels; and (4) adequate records to support accounting transactions, project files, procurement of developers, contractors, lenders, and appraisers. However, the County could improve internal controls for other

program activities by developing separate, specific, and well-documented policies and procedures for those activities.

### **What We Recommend**

We recommend that the Director of the Los Angeles Office of Community Planning and Development require the County to create and maintain policies and procedures specific to Program acquisition activities.

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

### **Auditee's Response**

We provided the County a discussion draft report on December 11, 2009, and held an exit conference with the County's officials on December 16, 2009. The County provided written comments on December 22, 2009, and generally agreed with our findings.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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## BACKGROUND AND OBJECTIVE

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The Neighborhood Stabilization Program (Program) was authorized under Title III of the Housing and Economic Recovery Act of 2008 (HERA) and provides grants to every State and certain local communities to purchase foreclosed-upon or abandoned homes and to rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem declining values in neighboring homes. HERA calls for allocating funds “to states and units of general local government with the greatest need,” and in the first phase of the program, HUD allocated more than \$3 billion in Program funds to assist in the redevelopment of abandoned and foreclosed-upon homes.

On September 26, 2008, the U.S. Department of Housing and Urban Development (HUD) announced that the County of Riverside (County) would receive more than \$48.5 million as part of the Program. These targeted funds are being used to acquire foreclosed-upon homes; demolish or rehabilitate abandoned properties; and/or offer purchase price and optional home repair and rehabilitation assistance to low-, moderate-, and middle-income home buyers.

As of October 21, 2008, there were more than 29,107 foreclosed-upon properties in Riverside County—nearly 3.8 percent of all housing units. When the preforeclosures and units at auction are included, the number of impacted housing units is nearly 52,000, or 7 percent of all housing units. The County’s Program allocation is the third highest (non-State) allocation in the Country, and the Riverside-San Bernardino metropolitan statistical area is the fourth most impacted region in the Nation.

The County had implemented four HUD-approved activities with its Program funds:

- 1) Program activity one was designed to acquire and rehabilitate foreclosed-upon or abandoned single-family homes and sell them to income-eligible first-time home buyers. The County has partnered with various public and private nonprofit organizations to carry out this activity. It anticipated 150 units being made available to households with incomes at 51 to 120 percent of the area median income. The County budgeted more than \$24 million toward this activity. See appendix C for an example property.
- 2) Program activity two was designed to acquire and rehabilitate foreclosed-upon or abandoned single-family homes and rent them to households earning not more than 120 percent of the County area median income. The County will partner with various public and private nonprofit organizations to carry out this activity. It budgeted more than \$500,000 toward this activity.
- 3) The Neighborhood Stabilization Homeownership Program was designed to offer a financing mechanism to eligible first-time home buyers to enable them to directly acquire foreclosed-upon or abandoned single-family homes using Program funds. The program provides downpayment assistance to low- and moderate-income households that have not owned homes within a 3-year period. The program is available for households with an annual income that is no greater than 120 percent of the area median income as published

by HUD. The total amount of assistance for each home will not exceed \$75,000. The County budgeted more than \$9 million toward this activity. See appendix C for an example property.

- 4) Program activity four was designed to meet its requirement to expend at least 25 percent of Program funds on projects that provide affordable housing to persons and families earning less than 50 percent of the area median income. The County will partner with various public and private development organizations to provide for the redevelopment or new construction of affordable multifamily rental projects. The County budgeted more than \$8 million toward this activity. See appendix C for an example property.

Properties eligible for all four programs must be located within specific target areas, or census tracts, which have been defined by the County and approved by HUD as areas with the greatest need. Almost \$5 million in Program funds will be used to administer the various activities.

HUD is considering applications submitted under a competitive second round of funding for additional Program funds. These funds are authorized by the American Recovery and Reinvestment Act of 2009 (ARRA). The County's application for this round of funding included a budget request of approximately \$40 million to continue its acquisition, rehabilitation, and resale activities.

### **Our Objective**

Our objective was to determine whether the County had sufficient capacity and the necessary controls to manage and administer Program funds provided by HUD under HERA.

## RESULTS OF AUDIT

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### Finding: The County Did Not Develop Sufficient Program Policies and Procedures

Although the County had adequate policies and procedures for its financial and procurement activities and Neighborhood Stabilization Homeownership Program, it did not have separate, specific written/documented policies and procedures for its other Program activities. Instead, the County relied on the notice of funding availability for each activity and loan agreements executed with developers. It did not believe that specific Program policies and procedures were necessary, generally disregarding its own Standard Practice Manual. Without thorough, well-documented, Program-specific policies and procedures, the County operated its Program under a weakened control environment, increasing the risk of waste, fraud, and/or abuse.

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#### **Financial, Procurement, and Homeownership Policies and Procedures Were Adequate**

The County had complete written policies and procedures to support its financial management and procurement functions. In addition, the County's procedures were sufficient to support its Neighborhood Stabilization Homeownership Program. The procedures complied with the major provisions of HERA and addressed the major aspects of each program, including program requirements; monitoring; and County, applicant, and lender responsibilities.

#### **Acquisition Program Activities Lacked Policies and Procedures**

The County did not have well-documented written policies and procedures for its three Program acquisition activities.<sup>1</sup> The County's Standard Practice Manual calls for all County departments and agencies to establish, document, and maintain an effective system of internal control. The manual requires that well-documented policies and procedures be established and maintained to promote employee understanding of job duties, provide day-to-day guidance to staff, and help to ensure continuity during employee absences or turnover.

To ensure a sound internal control environment, the County's policies and procedures should include policies that discuss the purposes and objectives of the Program and procedures that establish, in considerable detail, the internal procedures of the various

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<sup>1</sup> The Program activities include single-family acquisition/resale, single-family acquisition/rental, and multifamily acquisition/rental (see Background and Objective section).

Program activities. The Program policies and procedures manual should be in sufficient detail to support every step and function of the County's various Program activities. The policies and procedures should provide instruction to all personnel directly related to Program activities, such as but not limited to developer approval, application processing, property selection and approval, rehabilitation, appraiser selection, lender selection, income eligibility, reimbursement processing, file maintenance, delegation, reporting requirements, monitoring requirements, and ensuring that Program personnel are free from conflicts of interest. The policies and procedures should also detail all relevant statutes, regulations, policies, procedures, and best practices applicable to all aspects of the Program. The areas addressed should include both internal and external processes.

Based on interviews with staff at all levels, the County felt satisfied with the language in its notices of funding availability and agreements with developers and its current Community Development Block Grant (CDBG) and HOME Investment Partnerships Program (HOME) policies and procedures. Further, the County was confident that staff and supervisory knowledge was sufficient. However, the County's attitude neglected the importance of documented controls as an integral part of the control environment.

#### **Notice of Funding Availability and Loan Agreements Were Not Adequate**

The County issued three separate notices of funding availability and executed loan agreements with developers for each of its three Program acquisition activities. These documents provided limited policies and external procedures adequate for use by developers. However, they did not fully document and specify all relevant internal policies and procedures to ensure solid internal controls, such as effectiveness and efficiency of operations, relevance and reliability of information, compliance with laws and regulations, and safeguarding of assets and resources. The notices of funding availability and loan agreements do not specify control activities and Program monitoring procedures in sufficient detail to keep staff informed of every relevant process and did not, by themselves, produce a sound control environment.

#### **Other Programs' Policies and Procedures Were Not Adequate**

We reviewed the County's CDBG and HOME policies and procedures and determined that they were not sufficient as policies and procedures for the County's Program activities.

- Although some of the CDBG processes were similar, they did not specifically address the Program and its specific requirements and regulations. Further, the County had modified some of its processes for its Program activities.

- The County lacked well-documented/written policies and procedures for its HOME program and relied on supervisory and staff experience/guidance.

## **Conclusion**

The County appeared to generally have sufficient capacity and adequate controls in several key areas to administer its award of Program funding in accordance with HERA requirements, which should also be adequate to administer the continuation of these programs under its proposed draft application for a second round of Program funds through ARRA. However, it should take additional steps to improve the procedures and controls of its activities to reduce the risk of waste, fraud, and abuse and improve its ability to administer current funding and any additional funding received.

## **Recommendations**

We recommend that the Director of the Los Angeles Office of Community Planning and Development require the County to

- 1A. Create and maintain policies and procedures specific to Neighborhood Stabilization Program single-family and multifamily acquisition activities.



## SCOPE AND METHODOLOGY

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We performed our on-site audit work at the County, located at Riverside, CA, between July and October 2009. Our audit generally covered the period December 2008 through October 31, 2009. We expanded our scope as necessary.

To accomplish our objective, we reviewed

- HERA.
- ARRA.
- The Program bridge notice, dated June 19, 2009.
- HUD regulations at 24 CFR (Code of Federal Regulations) Parts 85, 91, 92, and 570.
- The County's substantial amendment to its 2008-2009 action plan to include proposed Program activities.
- The Program grant agreement, dated February 25, 2009.
- Organizational charts
- HUD risk analyses for the CDBG, HOME, and Emergency Shelter Grant programs.
- The consolidated annual performance and evaluation report for fiscal year 2009.
- HUD monitoring reports.
- Disaster Recovery Grant Reporting System and Line of Credit Control System financial data.
- The single audit report for the year ending June 30, 2008.
- The County's internal policies and procedures that support Program activities. We also reviewed the County's financial management, procurement, and monitoring policies and procedures.
- Notices of funding availability for single-family acquisition/resale, single-family acquisition/rental, and multifamily acquisition/rental activities.
- Loan agreements with contracted developers.

- The procurement process and selections for appraisers, lenders, contractors, and developers.
- A nonstatistical<sup>2</sup> sample of four out of 64 available project files covering single-family acquisition/resale, homeownership assistance, and multifamily acquisition/rental activities. We generally found that the project files followed Program rules and regulations.
- Expenditure reports, journal vouchers, and supporting documentation, including the review of a nonstatistical<sup>3</sup> sample of \$497,241 out of \$2.2 million in Program expenses as of September 30, 2009. We generally found that each expense was eligible, followed Program rules and regulations, and was supported by documentation.
- The County's application for the second competitive round of Program funds.
- The County's progress in obligating funds based on the latest progress charts available during our fieldwork and information reported in HUD's Disaster Recovery Grant Reporting System as of December 2, 2009.
- We also interviewed County staff and several key developers responsible for Program execution and conducted site visits to a nonstatistical<sup>4</sup> sample of 12 funded and pending homes under the Program. We found that each property was in an eligible target area and supported the County's execution of eligible Program activities.

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 finding and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective.

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<sup>2</sup> Due to the County's limited production at the time of fieldwork, we selected files that were furthest along in the process. We selected files covering three of the four Program activities, including single family acquisition/resale, homeownership assistance, and multifamily acquisition/rental.

<sup>3</sup> Our sample was based on expenditures covering areas such as appraisal fees, advertising expenses, payroll, and program execution. We selected expenditures that were higher in dollar value.

<sup>4</sup> Due to the County's limited production at the time of fieldwork, we selected properties that were furthest along in the process and that covered most of the County run activities. We selected files covering single family acquisition/resale, homeownership assistance, and multifamily acquisition/rental activities.

# 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 achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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.

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## Relevant Internal Controls

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

- Implementation of policies and procedures to ensure that Program activities meet established objectives.
- Implementation of policies and procedures to ensure that Program activities comply with applicable laws and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if internal 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 that the following item is a significant weakness:

- The County lacked policies and procedures to ensure a sound internal control environment.


# APPENDICES

## Appendix A

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments

 <p>December 22, 2009</p> <p>Mr. Martin D. Herrera Senior Auditor Office of Inspector General Department of Housing and Urban Development 611 West 6<sup>th</sup> Street, Suite 1160 Los Angeles, California 90017</p> <p><b>Re: RESPONSE TO DRAFT REPORT</b></p> <p>Mr. Herrera:</p> <p>The County of Riverside Economic Development Agency (EDA) has received your draft finding outlines relative to your recent visit and monitoring of our Neighborhood Stabilization Program (NSP) activities and offers this statement in response.</p> <p><b>FINDING 1 – RIVERSIDE COUNTY DID NOT DEVELOP SUFFICIENT NEIGHBORHOOD STABILIZATION PROGRAM POLICIES AND PROCEDURES</b></p> <p>EDA is committed to ensuring compliance with every NSP, HUD and every other applicable regulation and preventing any waste, fraud or abuse. EDA contends that the application and guidelines available to the public for their solicitation or participation in the various EDA NSP programs, which are identified and presented to the public as a Notice of Funding Availability (NOFA), clearly identify the regulations and requirements that each project and applicant must comply with and the process of approving the eligible project and applicant. The same NOFA also clearly identifies the standards, regulations and requirements that staff must verify and ensure compliance with for each applicant and project. The NOFA was drafted in complete and consistent consideration of NSP regulations and the County of Riverside's Substantial Amendment. The NOFA was reviewed by County Counsel to ensure compliance with all applicable regulations. As a result, staff reconciled each application against the program requirements identified in the NOFA.</p> <p>Additionally, the Loan Agreement for the use of NSP funds entered into by and between the County of Riverside and each sub-grantee, is a direct result of the standards, regulations and requirements conditioned of each project and applicant by the NOFA. The</p> <p>1325 SPRUCE STREET, SUITE 400 • RIVERSIDE CALIFORNIA 92507 T 951.955.8916 • F 951.955.6686 • WWW.RIVCOEDA.ORG</p> <p><small>S:\Templates\EDA-006a-Letterhead-Color-Spruce.doc</small></p>
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Mr. Martin D. Herrera  
December 17, 2009  
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Loan Agreement was also reviewed by County Counsel to ensure compliance with all application regulations, the NOFA and (on a case by case basis) the individual program application. The Loan Agreement is clear as to every standard, condition and requirement that each project and sub-grantee must comply with and every one of the same which EDA staff must enforce.

EDA staff and management have undergone a great effort to ensure efficient program operation and in full compliance of every program regulation. EDA staff and management have been intricately involved in the production of every program guideline, application and NOFA to ensure efficient program operation simultaneous with program regulatory compliance.

Notwithstanding the above statements, EDA will comply with your recommendation to the Los Angeles Office of Community Planning and Development by creating and maintaining policies and procedures specific to NSP activities 1, 2 and 4 for program operation. EDA has started drafting said policies and procedures and expects to have a draft available for review by January 31, 2010 calendar year.

The County of Riverside and EDA remain fully committed to ensuring the successful implementation of the NSP programs in full compliance with the regulations and spirit of the Housing and Economic Recovery Act.

Thank you for your attention to this matter. Please call me at 951.955.3422 or email at [emilioramirez@rivcoeda.org](mailto:emilioramirez@rivcoeda.org) if you have any questions or concerns.

Sincerely,



Emilio Ramirez  
Assistant Director

cc: Mr. James Yerdon, HUD

**Comment 1**

## **OIG Evaluation of Auditee Comments**

**Comment 1** As stated in the report, the County's Standard Practice Manual requires that well-documented policies and procedures be established and maintained to promote employee understanding of job duties, provide day-to-day guidance to staff, and help to ensure continuity during employee absences or turnover. While the NOFA and loan agreements do identify Program standards, rules, and regulations. The documents cited by the County do not cover all internal and external processes involved in the administration of the Program. The County's willingness to adopt written policies and procedures specific to the Program will ensure the control environment is strengthened.

## Appendix B

### CRITERIA

**24 CFR 85.20(b).** The financial management systems of other grantees and subgrantees must meet the following standards:

1. Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.
2. Accounting records. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
3. Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

**County of Riverside Standard Practice Manual, No. 101.** Applicability.

The Standard Practice Manual applies to County departments, agencies, special districts, and authorities that are governed by Riverside County Board of Supervisors, and/or which maintain funds in the County Treasury. All areas identified within the scope of this policy assigned and/or engaged in accounting activities for the County are required to adhere to the policies and procedures contained in this manual.

**County of Riverside Standard Practice Manual, No. 104.** Internal control.

County departments and agencies shall establish, document, and maintain an effective system of internal control. The policy requires that well-documented policies and procedures are established and maintained to promote employee understanding of job duties, provide day-to-day guidance to staff, and help ensure continuity during employee absences or turnover.

*Government Auditing Standards, Chapter 7.15(c)*, states that internal control includes the plan, policies, methods, and procedures adopted by management to meet its missions, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.

Documenting and evaluating internal control (including policies and procedures) at the entity level is a solid starting point in building a strong internal control environment. When weaknesses are identified, an entity can refer to its documented control procedures and properly analyze and implement changes, if necessary. Additionally, well-documented controls provide

assurance and contribute to minimizing risk. Internal control can be broken down into four objectives:

- Effectiveness and efficiency of operations,
- Relevance and reliability of information,
- Compliance with laws and regulations, and
- Safeguarding of assets and resources.

To reach those objectives, internal control can be broken down into the following parts:

- Control environment: Sets the tone for the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control.
- Risk assessment: The identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed.
- Information and communication: Systems or processes that support the identification, capture, and exchange of information in a form and timeframe that enable people to carry out their responsibilities.
- Control activities: The policies and procedures that help to ensure that management directives are carried out.
- Monitoring: Processes used to assess the quality of internal control performance over time.



## Appendix C

### SITE VISITS

We conducted site visits and were able to confirm that the Program-funded homes were located within the areas targeted by the County as having the “greatest needs” and that homes with pending loans appeared to have been foreclosed-upon or abandoned.

- **Single-family acquisition/resale example:** Home was acquired and was actively being rehabilitated. Contractors were on site during site visit.



- **Homeownership assistance example:** Rehabilitation was complete on this single family residence. We toured the home and spoke to the home buyer, who praised the downpayment/rehabilitation assistance program.



- **Multifamily acquisition/rental example:** Multifamily project was in escrow during site visit. Although nearly complete, the County still needs to complete construction before rental.

