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Audit Report Number 2011-NY-1009
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TO: Anne Marie Uebbing, Director, Office of Community Planning and Development, 2FD

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

SUBJECT: The East Orange Revitalization and Development Corporation Did Not Always Comply With HOME Program Requirements and Federal Regulations

## **HIGHLIGHTS**

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

We audited the East Orange Revitalization and Development Corporation (Corporation). We selected the Corporation based on a request for an audit from the Newark U.S. Department of Housing and Urban Development (HUD) Office of Community Planning and Development. The objective of the review was to determine whether the Corporation complied with HOME Investment Partnerships Program (HOME) requirements and Federal regulations.

### **What We Found**

Corporation officials did not always comply with HOME program requirements and applicable Federal regulations. Specifically, they (1) did not repay the City of East Orange's (City) HOME program \$37,712 in principal and accumulated interest for an overdue predevelopment loan, and (2) expended \$737,437 in HOME grants without maintaining adequate and complete documents to ensure its compliance with HOME program requirements and applicable Federal regulations.

## **What We Recommend**

We recommend that the Director of HUD's New Jersey Office of Community Planning and Development instruct the City to (1) direct the Corporation to repay to the City's HOME program a total of \$37,712 in principal and accumulated interest for an overdue predevelopment loan, (2) direct the Corporation to provide documents to support its compliance with HOME program requirements and applicable Federal regulations or reimburse the City's HOME program \$737,437, (3) obtain and review documents associated with the Corporation's qualifications to determine whether it is qualified to be designated as a community housing development organization, and (4) direct the Corporation to establish and implement internal controls that will ensure compliance with HOME program requirements and applicable Federal regulations.

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 discussed the results of our audit with the Executive Director of the Corporation prior to the exit conference. On March 4, 2011, we e-mailed an electronic copy of the draft audit report to the Executive Director and mailed a hardcopy of the draft audit report to the Corporation. However, the Director of Corporation did not attend our exit conference meeting on March 17, 2011 at the office of the Director of Policy, Planning and Development Department of the City of East Orange.

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## **BACKGROUND AND OBJECTIVE**

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The East Orange Revitalization and Development Corporation (Corporation) is a private, nonprofit corporation organized under the laws of the State of New Jersey to provide clean, safe, and affordable housing and to further the provision of decent housing to moderate- and low-income households in the County of Essex. The Corporation is tax exempt under section 501(c) of the Internal Revenue Code of 1986 and is located at 160 Halsted Street, East Orange, NJ.

The Corporation is governed by a board of trustees consisting of seven members. The executive director is appointed by the board to manage the daily operation of the Corporation. The Corporation's fiscal year begins on the first day of January and ends on the last day of December of each year.

The HOME Investment Partnerships Program (HOME) is authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act. The HOME program regulations are at 24 CFR (Code of Federal Regulations) Part 92. The HOME program is the largest Federal block grant to State and local governments designed exclusively to create affordable housing for low-income households. The program's flexibility allows States and local governments to use HOME funds for grants, direct loans, loan guarantees or other forms of credit enhancement, rental assistance and security deposits.

On January 20, 2005, the City of East Orange's (City) Department of Policy, Planning, and Development, Division of Neighborhood Housing and Revitalization, granted City-wide community housing development organization (CHDO) status to the Corporation. On March 28, 2006, the City awarded the Corporation a predevelopment loan, an operating grant, and a construction grant in the amounts of \$35,000, \$50,000, and \$1 million, respectively, to construct the Princeton Street Phase II homes, which consisted of six newly built, affordable two-family homes.

The objective of the audit was to determine whether the Corporation complied with HOME program requirements and applicable Federal regulations.

## RESULTS OF AUDIT

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### Finding: Corporation Officials Did Not Always Comply With HOME Program Requirements and Applicable Federal Regulations

Corporation officials did not always comply with HOME program requirements and applicable Federal regulations. Specifically, they (1) did not repay the City's HOME program \$37,712 in principal and accumulated interest for an overdue predevelopment loan, and (2) expended \$737,437 in HOME grants without maintaining adequate and complete documents to ensure the Corporation's compliance with HOME program requirements and applicable Federal regulations. Therefore, (1) \$37,712 in loan receipts was not available for eligible HOME program activities, and (2) there was no assurance that \$737,437 in HOME grants awarded to the Corporation was used for eligible HOME program activities and expenses. These deficiencies occurred because Corporation officials did not have the administrative capacity to establish and implement internal controls to ensure the Corporation's compliance with HOME program requirements and applicable Federal regulations.

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#### **The Corporation Had Not Repaid a Predevelopment Loan's Principal and Accumulated Interest**

Contrary to the provision of a predevelopment loan agreement between the City and the Corporation and regulations at 24 CFR 92.301, as of August 28, 2010, Corporation officials had not repaid \$37,712 in loan receipts. This amount consisted of the loan's principal of \$35,000 and an accumulated interest balance of \$2,712 that was supposed to be repaid to the City's HOME program no later than January 28, 2008. This deficiency occurred because Corporation officials did not have proper administrative capacity to ensure the Corporation's compliance with HOME program requirements.

According to 24 CFR 92.301, HOME funds may be used by a participating jurisdiction to provide technical assistance and site control loans to CHDOs in the early stages of site development for an eligible project. The CHDO must repay the predevelopment loan to the participating jurisdiction from construction loan proceeds or other project income. The participating jurisdiction may waive repayment of the loan, in part or in whole, if there are impediments to project development that the participating jurisdiction determines are reasonably beyond the control of the borrower. However, the City did not waive the repayment of the loan due from the Corporation.

According to a predevelopment loan agreement between the City and the Corporation, the principal sum and interest, if any, shall be payable in a single

lump-sum payment on a date no later than 22 months from the date of the passage of the developer designation by the City Council. If the principal is not paid when due, it shall bear interest after maturity at the rate of 3 percent per year. The date of the approval of the developer designation by the City Council was March 28, 2006. Therefore, we calculated the interest due on the loan's principal from January 28, 2008, through August 28, 2010, to be \$2,712, using the interest rate cited in the loan agreement. Thus, a total of \$37,712 consisting of loan principle and interest is due to the City's HOME program and considered to be questioned.

**The Corporation Lacked Supporting Documents To Ensure Compliance With HOME Program Requirements**

Contrary to the provisions of the grant agreement between the City and the Corporation and applicable Federal regulations, the Corporation neither maintained nor provided adequate and complete documents to support its compliance with HOME program requirements and applicable Federal regulations. Specifically, documentation was not maintained or provided to support (1) the eligibility and reasonableness of costs paid from HOME grants awarded to the Corporation for the construction of the Princeton Street Phase II homes, (2) the initial certification and annual recertification of the Corporation to become and continue to operate as a CHDO, (3) compliance with procurement requirements for non-Federal entities, (4) compliance with environmental review requirements, (5) compliance with Davis-Bacon Act and overtime provisions, and (6) compliance with Office of Management and Budget (OMB) Circular A-133 requirements for performing annual audits. Therefore, there was no assurance that the \$737,437 disbursed was used for eligible HOME program activities and expenses. This deficiency occurred because the Corporation did not have proper administrative capacity to establish and implement internal controls to ensure its compliance with HOME program requirements and applicable Federal regulations. The details are as follows:

- 1) The Corporation neither maintained nor provided adequate and complete documents to support the eligibility and reasonableness of costs paid from HOME grants awarded to it for the construction of the Princeton Street Phase II homes.

According to 24 CFR 92.2, "community housing development organization" means a private nonprofit organization that has standards of financial accountability that conform to 24 CFR 84.21 (b) (2) and (6), Standards for Financial Management Systems. The regulation states that recipients' financial management systems shall provide records that identify adequately the source and application of funds for federally sponsored activities and accounting records, including cost accounting

records that are supported by source documentation. However, Corporation officials did not provide adequate and complete documents to support the eligibility and reasonableness of costs paid. For example, the City submitted its first check to the Corporation for \$52,098 to reimburse it for different payments, including a payment to ARTEX Studio, LLC, for architectural services. However, Corporation officials did not provide us with supporting documents, including a vendor invoice and copies of the front and back of cancelled checks, which would have shown that ARTEX Studio, LLC, had been paid and that the costs were eligible and related to the funded activity.

- 2) According to 24 CFR 92.2, the Corporation was required to meet legal, capacity, and organizational structure criteria to become and continue to operate as a CHDO. However, Corporation officials did not provide documents to support the Corporation's initial certification and annual recertification to become and continue to operate as a CHDO.
- 3) According to a grant agreement between the Corporation and the City, the Corporation was required to comply with 24 CFR 84.44 and 43, which require establishing written procurement procedures and conducting its procurement transactions in a manner to provide, to the maximum extent practical, open and free competition. However, Corporation officials did not provide procurement policy or documents to support compliance with these procurement requirements.
- 4) According to a grant agreement between the Corporation and the City, Corporation officials agreed to comply with all requirements of the HOME program as stated in 24 CFR Part 92, including but not limited to the following: No HOME project funds will be advanced, and no costs can be incurred until the City has conducted an environmental review of the proposed project site as required under 24 CFR Part 58. The environmental review may result in a decision to proceed with, modify, or cancel the project. However, Corporation officials did not provide complete documents to show that the environmental reviews had been properly completed before expending HOME grant funds on the construction of the Princeton Street Phase II project.

Corporation official provided a preliminary environmental review for three of the six lots used for the construction of the six new two-family homes. Yet, although the provided preliminary environmental review cited several environmental issues associated with two of the three examined lots, Corporation officials provided neither environmental review documents associated with the other three lots nor documents to support further investigation or cleanup and remediation of the two contaminated lots.

- 5) According to a grant agreement between the Corporation and the City, Corporation officials were required to comply with the provisions of the Davis-Bacon Act, as supplemented by 29 CFR Part 5, if the housing project under the grant agreement involved the construction or rehabilitation of 12 or more HOME-assisted units. However, Corporation officials did not provide documents to support the Corporation's compliance with the Davis-Bacon Act, although its housing project consisted of constructing six new two-family homes consisting of 12 units.
- 6) According to OMB Circular A-133 (Subpart B, section 200(a)), (for fiscal years ending after December 31, 2003) a non-Federal entity such as the Corporation that expends \$500,000 or more per year in Federal awards shall have a single or program-specific audit conducted for that year. Based on information included in financial statements and an independent compilation report prepared by a certified public accountant, the Corporation received and expended more than \$500,000 during the fiscal year ending December 31, 2008. However, Corporation officials did not provide documents to support that a single or program-specific audit was conducted for its fiscal year ending December 31, 2008.

According to a grant agreement between the Corporation and the City, the Corporation was required to provide the City, the U.S. Department of Housing and Urban Development (HUD), or any of their duly authorized representatives immediate access to any books, documents, papers, and records of the Corporation or its contractors, which are directly pertinent to the Corporation's housing project, for the purpose of conducting audits and examinations. However, Corporation officials were unable to provide us with many of the requested documents and records.

## Conclusion

Corporation officials did not always comply with HOME program requirements and applicable Federal regulations. Specifically, Corporation officials neither repaid an overdue predevelopment loan's principal and accumulated interest to the City's HOME program, nor maintained adequate and complete documents to ensure its compliance with HOME program requirements and applicable Federal regulations. In particular, documentation was not maintained or provided to support (1) the eligibility and reasonableness of costs paid from HOME grants awarded to the Corporation for the construction of the Princeton Street Phase II homes, (2) the eligibility of the Corporation to become and continue to operated as a CHDO, (3) the adequacy and fairness of the Corporation's procurement process, (4) its compliance with environmental review requirements, (5) its compliance with provisions of the Davis-Bacon Act, and (6) its compliance with OMB Circular A-133 requirements for performing annual audits. These



deficiencies occurred because Corporation officials did not have adequate administrative capacity to establish and implement internal controls to ensure the Corporation's compliance with HOME program requirements and Federal regulations. Therefore, a predevelopment loan's principal and accumulated interest of \$37,712 had not been repaid to the City's HOME program to be used for eligible HOME program activities, and \$737,437 had been expended on activities and expenses that were not adequately supported.

## Recommendations

We recommend that the Director of the New Jersey Office of Community Planning and Development instruct the City to

- 1A. Direct Corporation officials to repay to the City's HOME program a total of \$37,712 in principal and accumulated interest for an overdue predevelopment loan.
- 1B. Direct Corporation officials to provide documents to support the \$737,437 in unsupported expenses incurred to ensure the Corporation's compliance with HOME program requirements and applicable Federal regulations or reimburse this amount to the City's HOME program from non-Federal funds.
- 1C. Obtain and review documents associated with the Corporation's qualifications to determine whether it is qualified to be designated as a CHDO.
- 1D. Direct Corporation officials to establish and implement internal controls that will ensure the Corporation's compliance with HOME program requirements and Federal regulations.

## SCOPE AND METHODOLOGY

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The audit focused on the Corporation's compliance with HOME program requirements and applicable Federal regulations. To accomplish our objectives, we

- Reviewed relevant HOME program requirements and applicable Federal regulations.
- Interviewed staff from the New Jersey Office of Community Planning and Development, the City, and the Corporation.
- Obtained an understanding of the Corporation's management controls and procedures through analyzing its and the City's responses to internal control questionnaires.
- Analyzed reports from HUD's computer systems, including the Integrated Disbursement and Information System (IDIS), Line of Credit Control System, and LexisNexis.
- Reviewed the Corporation's financial statements such as its balance sheet and income statements.
- Reviewed HUD's monitoring reports and independent accountant audit reports.
- Reviewed a predevelopment loan agreement and a HOME grant agreement between the City and the Corporation, as well as related documents such as resolutions associated with the Corporation's board of trustees and the City Council.
- Reviewed a joint venture agreement between the Corporation and the Open Eye Innovators, LLC.
- Examined incomplete documents associated with the initial certification of the Corporation to become a CHDO and preliminary environmental reviews.
- Traced disbursements listed in IDIS reports to incomplete Corporation supporting documents.
- Selected all financial transactions such as disbursements and nonfinancial transactions such as a preliminary environmental review associated with the operations of the Corporation for testing. This testing was based on (1) the materiality of HOME grant awards to the Corporation in comparison to the average annual HOME grants awarded to the City and (2) the assessed risk level of noncompliance with HOME program requirements and applicable Federal regulations.
- Traced computerized data in HUD's e-LOCC's system to the City's records of disbursements to the Corporation, which was sufficiently reliable for our audit purposes, and

traced all disbursements of the City's HOME funds to the Corporation for the construction of the Princeton Street Phase II homes to copies of cancelled checks issued by the City to the Corporation.

The audit generally covered the period from September 1, 2005, through December 31, 2009, and was extended as needed to accomplish our objective. We performed the audit fieldwork from July through November 2010 at the City's Department of Policy, Planning, and Development located at 44 City Hall Plaza, East Orange, NJ.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

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

We assessed the relevant controls identified above.

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

## Significant Deficiency

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

- Adequate controls were not developed to properly safeguard resources, as Corporation officials did not repay the City's HOME program the principal and accumulated interest for a predevelopment loan (see finding).
- Corporation officials neither established nor implemented internal controls to ensure compliance with laws and regulations including HOME program requirements and applicable Federal regulations, as disbursements were not adequately supported (see finding).

## APPENDIXES

### Appendix A

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

<u>Recommendation number</u>	<u>Unsupported 1/</u>	<u>Funds to be put to better use 2/</u>
1A		\$37,712
1B	\$737,437	
Total	<u>\$737,437</u>	<u>\$37,712</u>

- 1/ 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.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if Corporation officials repay the predevelopment loan's principal and accumulated interest to the City's HOME program, the City can use these proceeds for eligible HOME program activities, and HUD could be assured that these proceeds would be put to better use.