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Audit Report

Office of Internal Audit

Housing and Community Development

CHDO Program

November 2007



Housing and Community
Development

CHDO Program

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OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

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Transmittal Letter

RICK BLACKWELL
PRESIDENT METRO COUNCIL

November 27, 2007

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Re: Audit of Housing's Community Housing Development Organization Program

Introduction

An audit of the Community Housing Development Organization (CHDO) program was performed. The Housing and Community Development division of the Housing and Family Services Department administers the program. The primary focus of the audit was the operational and fiscal administration of the activity. This included how Housing processes, records and monitors the activity. While compliance with laws and Federal guidelines were considered, this was not a Federal A-133 Single Audit review.

The audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

As a part of the review, the internal control structure was evaluated. The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Achievement of business objectives and goals
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets

There are inherent limitations in any system of internal control. Errors may result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel factors. Some controls may be circumvented by collusion. Similarly, management may circumvent control procedures by administrative oversight.

Scope

The operating policies and procedures for the Community Housing Development Organization program were reviewed through interviews with key personnel. The primary focus was the operational and fiscal administration of the activity. Tests of sample data were performed for transactions from the period July 1, 2006 through June 30, 2007. While compliance with laws and Federal guidelines were considered, a Federal A-133 Single Audit was not performed.

The review included assessing whether activity was processed, recorded, and monitored accurately and appropriately. The details of the scope and methodology of the review will be addressed in the Observations and Recommendations section of this report. The examination would not identify all issues because it was based on selective review of data.

Opinion

It is our opinion that the administration of Housing's Community Housing and Development Organization program is satisfactory. The internal control rating is on page 5 of this report. This rating quantifies the opinion regarding the internal controls, and identifies areas requiring corrective action. While the overall rating is satisfactory, some opportunities to strengthen the internal control structure were noted. Examples of these include the following.

- **Processing Timeliness.** The timeliness of processing financial activity could be improved. This includes processing reimbursement requests to Federal Housing and Urban Development as well as the depositing of program income received. These delays impair the investment opportunities for Metro, and could result in less funding for other programs.
- **Supporting Documentation.** Some documentation which provides support that Housing's internal policies and procedures were complied with was missing from the files. This documentation included physical inspections, eligibility of contractors, and CHDO recertifications. Without this support documentation, it cannot be conclusively determined if the activity was administered in compliance with internal policies and procedures.
- **New Drawdown Procedures.** Effective July 1, 2007, the responsibility for processing Federal reimbursement requests was transferred from Housing to Metro's

Finance and Administration Department. At the time of the review, the drawdown procedures were being revised. Until the new procedures are finalized and implemented, there is an increased risk that activity may not be processed as intended.

The implementation of the recommendations in this report will help strengthen the internal control structure and effectiveness of the CHDO program.

Corrective Action Plan

Representatives from Housing and Community Development have reviewed the results and are committed to addressing the issues noted. Housing's corrective action plans are included in this report in the Observations and Recommendations section. We will continue to work with Housing to ensure the actions taken are effective to address the issues noted.

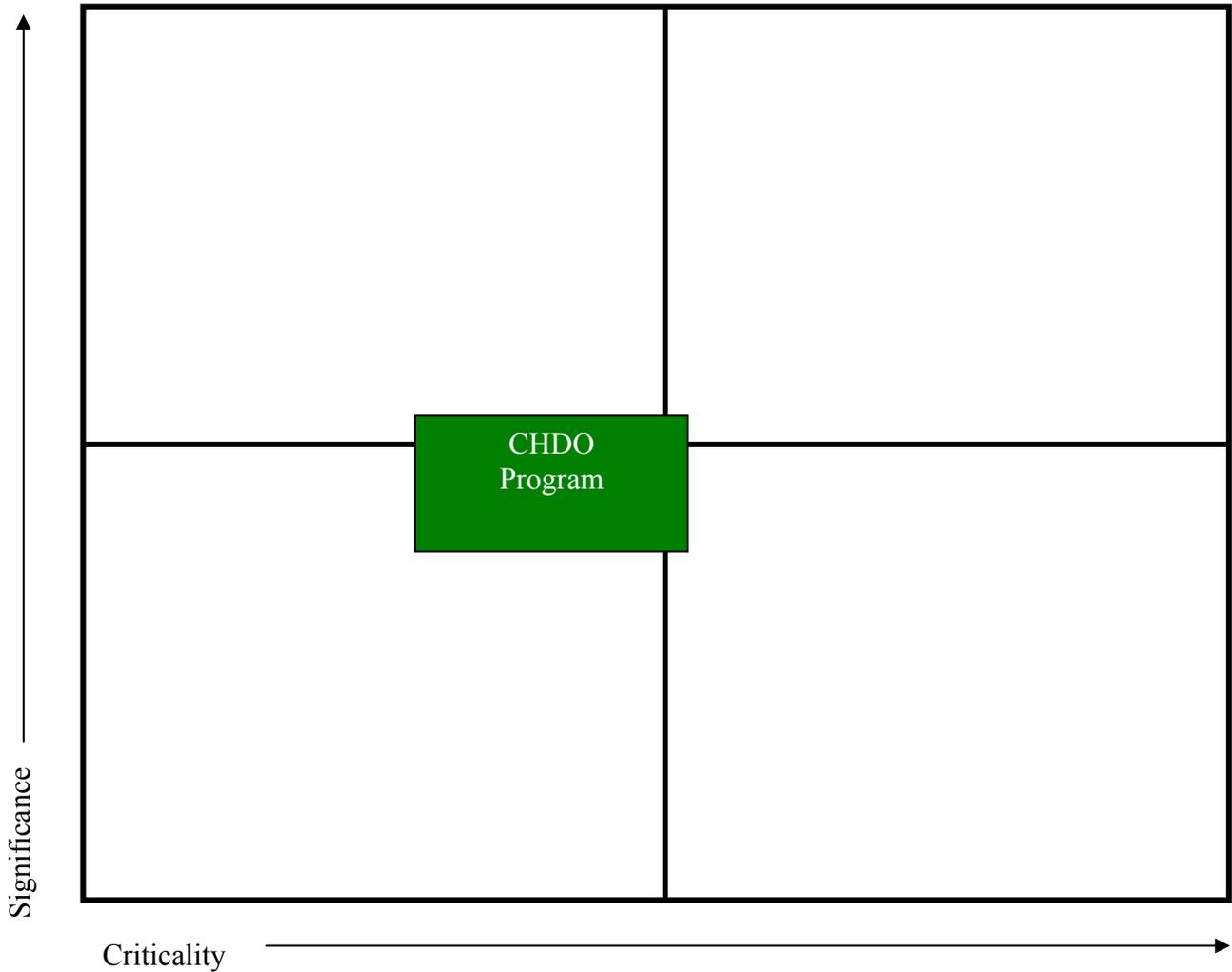
Sincerely,



Michael S. Norman, CIA, CFE, CGAP
Chief Audit Executive

cc: Louisville Metro Council Audit Committee
Louisville Metro Council Members
Deputy Mayors
Director of Housing and Family Services
Director of Housing and Community Development
Louisville Metro External Auditors

Internal Control Rating



<u>Legend</u>			
<i>Criteria</i>	<u>Satisfactory</u>	<u>Weak</u>	<u>Inadequate</u>
<i>Issues</i>	Not likely to impact operations.	Impact on operations likely contained.	Impact on operations likely widespread or compounding.
<i>Controls</i>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<i>Policy Compliance</i>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<i>Image</i>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<i>Corrective Action</i>	May be necessary.	Prompt.	Immediate.

Background

The Housing and Community Development Division of the Housing and Family Services Department administers the Community Housing Development Organization (CHDO) program. The mission of Housing and Community Development is to promote a wide choice of housing with nearby work and shopping for every citizen of the community, and to provide affordable housing opportunities for low and moderate income individuals and families.

The CHDO program is funded with U.S. Department of Housing and Urban Development (HUD) HOME funds. The HOME program requires that at least 15% of the annual HOME funds allocation be set aside for housing to be owned, developed, or sponsored by Community Housing Development Organizations.

CHDOs are grass roots, non-profit, agencies formed for the construction of single-family homes to service low to moderate-income families. Any agency or group may become certified as a CHDO provided they meet criteria set forth by U.S. HUD. Target neighborhoods for CHDO activities have been California, Chickasaw, Germantown, Park DuValle, Parkland, Portland, Russell, Smoketown, Shelby Park, and South Louisville.

For fiscal year 2007, Housing and Community Development's capital budget for HOME funds was \$3,481,400. Since no less than 15% of the funds are to be set aside for CHDOs, this equates to \$522,210 for CHDO activity.

This audit was scheduled as a result of a request by the new Director of Housing and Community Development. Subsequent discussions were held to define the objective and scope of the audit. The Director of Housing and Community Development should be commended for requesting this audit.

Summary of Audit Results

I. Current Audit Results

See Observations and Recommendations section of this report.

II. Prior Audit Issues

The Metro Office of Internal Audit has not performed prior reviews of Housing's Community Housing and Development Organization program. Federally funded programs are routinely reviewed as part of Metro's Federal A-133 Single Audit, which is performed by external auditors. The Metro Office of Internal Audit does not routinely review these programs in order to avoid duplication of efforts.

III. Statement of Auditing Standards

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

A formal study of the internal control structure was conducted to obtain a sufficient understanding in order to support the final opinion.

V. Statement of Irregularities, Illegal Acts, and Other Noncompliance

The examination did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the examination that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Observations and Recommendations section of this report.

VI. Views of Responsible Officials/Action Plan

A draft report was issued to Housing and Community Development on October 31, 2007. An exit conference was held at Housing and Community Development on November 14, 2007. Attending were Wally Deener, Charlie Horton, Kevin Sullivan, and Anna Wallace representing Housing and Community Development; Mary Ann Wheatley and Michael Norman representing Internal Audit. Final audit results were discussed.

The views of Housing and Community Development officials were received on November 27, 2007 and are included as corrective action plans in the Observations and Recommendations section of the report. The plans indicate a commitment to addressing the issues noted.

LMCO §30.36(B) requires Louisville Metro Agencies to respond to draft audit reports in a timely manner. It specifically states that

“The response must be forwarded to the Office of Internal Audit within 15 days of the exit conference, or no longer than 30 days of receipt of the draft report.”

The Housing and Community Development’s response was provided within this required timeframe.

Observations and Recommendations

Scope

The operating policies and procedures for the Community Housing Development Organization program were reviewed through interviews with key personnel. The primary focus was the operational and fiscal administration of the activity. While compliance with laws and Federal guidelines were considered, a Federal A-133 Single Audit was not performed.

Tests of sample data were performed for transactions from the period July 1, 2006 through June 30, 2007. A sample of five transactions was judgmentally selected for review from the population of CHDO expenditures during the period. The sample included all active CHDOs during the period. An additional sample transaction representing Program Income was judgmentally selected.

Activity reviewed included certifications, contractual agreements, work program budgets, expenditures and program income, transactions posted to Metro's Leap financial system, and information recorded in U.S. HUD's Integrated Disbursement and Information System. Effective July 1, 2007, responsibility for drawdown requests to Federal HUD was transferred from Housing to the Finance and Administration Department. Drawdown procedures were being revised and were not available for review. Therefore, the new drawdown procedures were not part of this review.

The audit included assessing whether activity was processed, recorded, and monitored accurately and appropriately. The review would not reveal all issues because it was based on selective review of data. The following issues were noted.

Observations

The overall internal control structure of Housing's CHDO program is satisfactory. However, some opportunities were noted to strengthen the controls. The opportunities are as follows.

- #1 Processing Timeliness
- #2 Supporting Documentation
- #3 New Drawdown Procedures

Details of these begin on the following page.

#1 – Processing Timeliness

The following issues were noted related to the timeliness of processing.

- **Program Income.** HOME funds can be provided to the CHDO for land acquisition costs. At closing, the funds are to be returned to Housing and Community Development. This is considered program income and is to be processed in accordance with Metro cash management policies and procedures (deposit whenever funds exceed \$1,000 or within one week of receipt).
 - For the sample transaction reviewed, it took seven business days to deposit the \$23,000 check received from the CHDO.

- **Drawdowns.** After Housing and Community Development pays a CHDO for project expenses, a drawdown is requested from Federal Housing and Urban Development for the expenses paid. Delays in requesting the drawdown result in Metro funds being temporarily diverted from other programs, and impact the amount of funds available for investment opportunities.
 - Of the five transactions reviewed, two were not requested timely.
 - One was for \$66,500. It was 62 days from the check date until the draw date.
 - The other was for \$23,000. It was 112 days from the check date until the draw date.

Recommendations

Appropriate Housing and Community Development personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ Checks and other revenue should be deposited in accordance with Metro policy. This helps ensure assets are safeguarded and helps provide additional investment opportunities for Metro.
- ✓ Housing personnel that routinely process revenue should be reminded of Metro's cash management policy and the necessity of adhering to it.
- ✓ The responsibility for drawdown processing was transferred from Housing and Community Development to Metro's Finance and Administration Department (*see Recommendation #3*). This may help alleviate the delays in processing the draw downs. Housing personnel should monitor the activity they are responsible for to ensure it is processed timely.

#2 – Supporting Documentation

Issues were noted with the lack of supporting documentation in Housing's files. Without this supporting documentation, it can not be determined if Housing's policies and procedures were complied with. Examples include the following.

- **Physical Inspection.** Housing's internal policies and procedures require that a physical inspection of the property be performed before approval of a CHDO's request for payment. The inspection is documented using the Inspection Request Transmittal form.
 - For the sample transactions reviewed, there were three cases in which an inspection would have been required. One of the three did not have an Inspection Request Transmittal form.

- **Federal Debarment List.** Housing's internal policies and procedures require verification that the CHDO's contractor has not been debarred from participating in Federal contracts. This is verified by reviewing the Federal Suspension and Debarment list available on the internet. If the contractor is not on the list, then they are eligible to contract. This verification was not documented in any of the five cases reviewed.

- **CHDO Recertifications.** Housing's internal policies and procedures require that the CHDO be recertified annually while the project is in progress. The initial certification process requires that the CHDO submit various documents and forms. This documentation is maintained in the CHDO file.
 - Four of the CHDOs in the sample did not have the recertification documented. The checklist located in the files indicated that the documents needed for the original certification were received. However, there is no indication that the information which could change was verified for the recertification period.

Recommendations

Appropriate Housing and Community Development personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ Housing should maintain documentation of the inspections performed prior to approval of payments to CHDOs.

- ✓ Housing should review the policy of verifying that CHDO's contractors are eligible for Federal contracts. If it is determined that this policy is necessary, then the verification should be properly documented.

- ✓ Housing should review the policy of requiring annual recertifications of the active CHDOs. If it is determined that this policy is necessary, then the recertification should be properly documented.

#3 – New Drawdown Procedures

After Housing and Community Development pays a CHDO for project expenses, a drawdown is requested from Federal Housing and Urban Development for the expenses paid. Effective July 1, 2007, the responsibility for processing drawdowns was transferred to Metro's Finance and Administration Department. At the time of the review, the procedures were being revised. Until the new procedures are finalized and implemented, there is an increased risk that activity may not be processed as intended.

Recommendations

Appropriate Housing and Community Development personnel should take corrective action to address the issues noted.

- ✓ Housing and Community Development should ensure that their roles and responsibilities in the revised drawdown procedures are understood and properly implemented.
- ✓ The revised drawdown procedures should be included in future A-133 Federal Single Audits performed by Metro's external auditors. This will provide an opportunity to address any issues with the new procedures. Therefore, no other recommendations will be made at this time.

Housing's Corrective Action Plan

Housing's corrective action plan begins on the following page.



MEMORANDUM

TO: Michael Norman, Office of Internal Audit

FROM: Kevin Sullivan, Housing & Family Services

DATE: November 27, 2007

RE: Draft Audit Report Recommendations – CHDO Housing Program

Please see the following actions to be implemented in response to the recommendations of the Office of Internal Audit in order to strengthen controls of the CHDO Housing Program:

1. Processing Timeliness:
 - The Housing & Community Development Division will deposit all checks and revenue from HOME Program Income in accordance with Metro policy.
2. Supporting Documentation:
 - Physical inspection of CHDO projects will be conducted prior to approval of a CHDO's request for payment, per Louisville Metro's CHDO Program policy.
 - Federal Debarment verification will be documented in all CHDO project files.
 - CHDO annual recertification will be documented in all CHDO boiler plate files.
3. New Drawdown Procedures:
 - Effective July 1, 2007 the Grants Management Division in the Finance Department assumed responsibility for performing the drawdown of federal funds administered in the Housing and Community Development Division.

- The Grants Management Division will review expenditures in the federal grant programs on weekly basis. The Business Office of the Housing and Family Services Department and the Program Administration Division in the Housing and Community Development Division will assist by reviewing and reconciling the revenue and expenditure accounts from the LeAP system to the HUD IDIS system.
- Once the accounts are reconciled the Grants Management Division will perform the drawdown for the appropriate grant programs.
- The Grants Management Division will be responsible for preparing and reconciling the SF 272, Federal Cash Transaction Report on a quarterly basis.
- When the report is completed Grants Management will present it to the Housing and Community Development Division for review, approval and submission to U. S. HUD.