Issue Date
May 24, 2012
Audit Report Number
2012-AT-1010

TO: Charles Franklin, Director, Community Planning and Development Division, 4CD

//signed//

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

SUBJECT: The Alabama Department of Economic and Community Affairs, Montgomery, AL, Did Not Follow Its Neighborhood Stabilization Program Requirements

HIGHLIGHTS

What We Audited and Why

We audited the State of Alabama's Department of Economic and Community Affairs' (grantee) Neighborhood Stabilization Program (NSP1) in Montgomery, AL, to assess issues raised in a hotline complaint. The complaint alleged that the State of Alabama misused its NSP1 funds by not following the regulations and statutes governing the NSP1 program to ensure that it used program funds for eligible and supported purposes. The State was awarded a $37 million grant authorized under the Housing and Economic Recovery Act of 2008.

The objective of our audit was to determine whether the grantee properly used its NSP1 funds as required by the regulations and statutes governing program income and expenditures.

What We Found

The grantee did not ensure that it disbursed program income before requesting additional program fund withdrawals from the U.S. Treasury. In addition, it did not report accurate program income in HUD's Disaster Recovery Grant Reporting system as required by Federal regulations. This condition occurred because the grantee relied on its subgrantees to identify and self report the program income as it was earned. By not disbursing program income before requesting additional program fund withdrawals from the U.S. Treasury, the grantee could not assure HUD that it used the appropriate amount of program income before using grant funds. As a result, the grantee had grant funds of $304,043 that could be put to better use.

The grantee did not ensure that its subgrantees drew program funds for supported expenditures. This condition occurred because the grantee did not require its subgrantees to provide supporting documentation when submitting draw requests. Without supporting documentation to substantiate the actual expenses, the grantee lacked assurance that the expenditures were accurate and program related. As a result, the grantee drew $8,540 in grant funds for unsupported expenditures.

What We Recommend

We recommend that the Director for Community Planning and Development require the grantee to (1) use program income of $304,043, or the current amount available before drawing additional grant funds from the U.S. Treasury, (2) develop and implement policies and procedures to ensure that the grantee identifies and tracks program income so that it is used before the grantee requests additional cash withdrawals from the U.S. Treasury, (3) reconcile the Disaster Recovery Grant Reporting system to accurately reflect the grantee's use of its grant funds and program income, (4) provide supporting documentation for the $8,540 charged to its program or repay the U.S. Treasury account from non-Federal funds the amount that it cannot support, and (5) develop and implement policies and procedures for its disbursement review and approval process.

For each recommendation in the body of this report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed our review results with HUD, the grantee, and subgrantee officials during the audit. We provided a copy of the draft report to the grantee on April 23, 2012, for its comments and discussed the report with grantee officials at the exit conference on May 2, 2012. The grantee provided written comments on May 3, 2012. It 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 B of this report.

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BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program (NSP1), authorized under Title III of the Housing and Economic Recovery Act of 2008 implemented actions to stabilize communities affected by foreclosures and abandonment. The purpose of the program is to provide emergency assistance to acquire and redevelop abandoned and foreclosed-upon homes. The funding is provided by the U.S. Department of Housing and Urban Development (HUD). HUD allocated $3.92 billion on a formula basis to States, territories, and local governments.

On March 11, 2009, HUD awarded an NSP1 grant of $37 million to the State of Alabama's Department of Economic and Community Affairs (grantee). The grantee is located in Montgomery, AL. The NSP1 funds were administered by the grantee as a component of its Community Development Block Grant program. The grantee selected 11 subgrantees to administer its NSP1 funds. The grantee is responsible for ensuring that each subgrantee fully complies with NSP1 requirements. The program is regulated by HUD and monitored by HUD's Birmingham Office of Community Planning and Development.

The grantee's activity priorities were acquisition and rehabilitation of residential properties and necessary financing mechanisms. All funds had to be obligated by September 10, 2010, and must be expended by March 10, 2013. The grantee obligated all of its funds as required. As of September 30, 2011, the grantee had expended total funds of about $34.6 million. It expended about $16 million of its funds toward the low-income housing 25 percent set-aside requirement to purchase and redevelop abandoned or foreclosed-upon homes or residential properties that will house individuals or families whose incomes do not exceed 50 percent of area median income.

The audit objective was to determine whether the grantee properly used its NSP1 funds as required by the regulations and statutes governing program income and expenditures.

RESULTS OF AUDIT

Finding 1: The Grantee Did Not Disburse Program Income Before Requesting $304,043 of Its Grant Funds

The grantee did not ensure that it disbursed program income before requesting additional program fund withdrawals from the U.S. Treasury. In addition, it did not report accurate program income in HUD's Disaster Recovery Grant Reporting system as required by Federal regulations. This condition occurred because the grantee relied on its subgrantees to identify and self report the program income as it was earned. By not disbursing program income before requesting additional program fund withdrawals from the U.S. Treasury, the grantee could not assure HUD that it used the appropriate amount of program income before using grant funds. As a result, the grantee had grant funds of $304,043 that could be put to better use.

The Grantee Did Not Use Its Program Income First

The grantee did not ensure that it disbursed program income before requesting additional program fund withdrawals from the U.S. Treasury. As provided in 24 CFR (Code of Federal Regulations) 85.21, grantees and subrecipients must disburse program income before requesting additional cash withdrawals from the U.S. Treasury. Federal Register notice FR-5255-N-01, section II N.3, provides that substantially all program income must be disbursed for eligible NSP1 activities before additional cash withdrawals are made from the U.S. Treasury. HUD's NSP Policy Alert, dated July 13, 2011, further explains that program income works on a first-in, first-out basis. It must be used before additional grant funds are drawn down.

In addition, the grantee did not report accurate program income in HUD's system as required by Federal regulations. Federal Register notice FR-5255-N-01, section II O.1(b), provides that each grantee must submit a quarterly performance report using HUD's Web-based system. However, the grantee submitted inaccurate quarterly performance reports to HUD's system that understated program income received.

The program income in HUD's system was understated by more than $1.7 million as of September 30, 2011. All five subgrantees earned program income that was not accurately reported in HUD's system. Collectively, the five subgrantees had earned more than $2 million in program income as of September 30, 2011. However, the quarterly performance report that the grantee recorded in HUD's system included only $271,296 in program income received by these five subgrantees. Consequently, HUD's system understated the program income by more than $1.765 million, as shown in the table below.

Subgrantee	Program income earned as of September 30, 2011	Program income reported in HUD's system	Amount of program income that was understated in HUD's system
1	$ 383,259	$ 0	$ 383,259
2	426,122	91,572	334,550
3	1,117,912	111,405	1,006,507
4	104,296	68,319	35,977
5	5,075	0	5,075
Total	$ 2,036,664	$ 271,296	$1,765,368

While program income was available and understated in HUD's system by $1.7 million, the grantee improperly withdrew $304,043 from its grant. The remaining $1.5 million of understated program income did not result in outlays from the grant, because two of the five subgrantees did not draw additional grant funds while program income was available. However, three of the five subgrantees had program income available and did not use it before drawing down additional grant funds as stated below.

- Subgrantee 1 - The subgrantee overdrew $93,791 from its grant funds. The subgrantee's affiliated nonprofits sold homes from January 12, 2010 to January 28, 2011, that accumulated $93,791 of program income. However, the subgrantee made all draws from its program grant funds and did not begin using the program income until a draw in December 2011 that used $67,683 of its program income. As a result, the subgrantee had $93,791 in program income on hand that should have been used before the program grant funds.

- Subgrantee 2 - The subgrantee overdrew $113,417 from its grant funds. It earned $113,417 in program income from two home sales on February 7 and June 30, 2011. The subgrantee incorrectly reported the program income to the grantee from the February 7 home sale and it did not disclose any program income to the grantee from the June 30 home sale. After earning this program income, the subgrantee withdrew $144,627 of its program funds, of which $113,417 should have been withdrawn from its program income.

- Subgrantee 3 - The subgrantee overdrew $96,835 from its grant funds. It earned $96,835 in program income on September 14, 2010. This income was not identified and tracked on a timely basis by the grantee, and the grantee did not disburse any program income until February 23, 2011. However, before using its program income, the subgrantee made two draws from its U.S. Treasury program funds totaling $361,377 of which, $96,835 should have been drawn from the program income it had already earned.

The grantee improperly withdrew the grant funds first and did not accurately report program income in HUD's system in a timely fashion because it relied on its subgrantees to identify and self report the program income. The grantee's program supervisor stated that the grantee relied on subgrantees to self-report program income when it was earned and that was how they intended to make sure program income was used first. However, this self-reporting did not work because subgrantees delayed or overlooked informing the grantee that program income had been received. This activity went undetected because the grantee lacked alternative procedures to effectively identify when program income was earned to ensure that this income was used first by its subgrantees. Consequently, the grantee improperly withdrew $304,043 from its U.S. Treasury grant funds before withdrawing its program income on hand.

Corrective Actions Were Taken During the Audit

The grantee was responsive to preliminary results we provided to it during the audit and began taking corrective action. Grantee and subgrantee officials acknowledged that program income had been earned but not disclosed on a timely basis and that this income should have been used first. The grantee's program supervisor told us that she had coordinated with HUD Community Planning and Development officials to reimburse the grant funds from the program income amounts with the next draw requests to be processed for two of the subgrantees that had withdrawn grant funds first. The supervisor told us that the third subgrantee had no draws pending, so the grantee requested the return of the NSP1 grant funds from its subgrantee. She told us that the returned NSP1 funds were then used as payment toward the next draw request from the subgrantee. These corrective measures will require verification by HUD's Office of Community Planning and Development to ensure that they were completed properly.

The grantee also began developing procedures to track draws from the grant and for identifying, tracking, and disbursing program income to ensure that it is used first. The grantee's corrective actions also included revising the financial information reported in its quarterly performance reports in the HUD system. These entries made during the audit require further review and reconciliation to ensure that the HUD system accurately reflects the current amount of program income.

Conclusion

The grantee did not ensure that it disbursed program income before requesting additional cash withdrawals from the U.S. Treasury. In addition, it did not report accurate program income in HUD's system. Program income works on a first-in, first-out basis. It must be used before additional grant funds are drawn down.

However, none of the five subgrantees that earned program income accurately reported that income in HUD’s system, and three did not use their program income before drawing down additional grant funds. This condition occurred because the grantee relied on subgrantees to self-report program income when it was earned. Consequently, $304,043 in grant funds drawn from the U.S. Treasury should be put to better use.

Recommendations

We recommend that the Director, Office of Community Planning and Development, require the grantee to

1A. Use program income of $304,043, or the current amount available, before drawing additional grant funds from the U.S. Treasury.

1B. Develop and implement policies and procedures to ensure that the grantee identifies and tracks program income so that it is used before requesting additional cash withdrawals from the U.S. Treasury.

1C. Reconcile the Disaster Recovery Grant Reporting system to accurately reflect the grantee’s use of its grant funds and program income.

Finding 2: The Grantee Did Not Ensure That Program Fund Expenditures Were Adequately Supported

The grantee did not ensure that its subgrantees drew program funds for supported expenditures. This condition occurred because the grantee did not require its subgrantees to provide supporting documentation when submitting draw requests. Without supporting documentation to substantiate the actual expenses, the grantee lacked assurance that the expenditures were accurate and program related. As a result, the grantee drew $8,540 in grant funds for unsupported expenditures.

$8,540 in Expenditures Was Unsupported

The grantee did not administer its grant in compliance with the Housing and Economic Recovery Act of 2008 and applicable Federal regulations to ensure that subgrantees drew grant funds for supported expenditures. Based on a nonstatistical random sample of disbursements to five subgrantees, we determined that one subgrantee drew grant funds for unsupported expenditures totaling $8,540. The remaining expenditures tested were supported with bank statements, canceled checks, vendor invoices, residential home sales contracts, and HUD-1 settlement statements when applicable.

For the subgrantee with the unsupported expenditures, we tested a nonstatistical random sample of 11 draws totaling more than $1 million and identified one draw with unsupported costs. The draw request totaled $673,285 for property acquisitions and acquisition activity delivery expenses.

The subgrantee did not have sufficient documentation to support $8,540 in expenditures. Regulations at 24 CFR 85.20(b)(6) require that expenditures be supported with canceled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc. While we were on site, the subgrantee could not provide supporting records for the expenditures.

After we left the subgrantee site, the grantee made additional efforts to locate support for the $8,540. The grantee was unable to locate evidence to support $2,365 of the $8,540. However, it located and provided partial support for the remaining $6,175. The documents and invoices that the grantee provided partially supported the draws but required more testing to determine whether the supporting invoices were paid in other draws. Therefore, we were unable to verify the support for the $8,540.

The grantee did not require subgrantees to submit supporting documentation before approving disbursement requests. The grantee's program supervisor stated that they did not want to risk impeding the program's progress by slowing down the draw requests. Instead, the grantee would test expenditures when it performed onsite monitoring of its subgrantees. The problem with this procedure was that draws made after the monitoring review were not verified. The deficiencies created a risk environment that allowed subgrantees to draw grant funds for unsupported expenditures.

Conclusion

The grantee did not ensure that the subgrantees had adequate records to properly support their expenditures. This occurred because the grantee did not require its subgrantees to provide support such as receipts and invoices, when subgrantees submitted draw requests. As a result, the grantee lacked assurance that expenses totaling $8,540 charged to the program were accurate.

Recommendations

We recommend that the Director, Office of Community Planning and Development, require the grantee to

2A. Provide supporting documentation for the $8,540 charged to its program or repay the U.S. Treasury account from non-Federal funds the amount that it cannot support.

2B. Develop and implement policies and procedures for its disbursement review and approval process.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Reviewed and obtained an understanding of relevant Housing and Economic Recovery Act of 2008 legislation, the Federal Register, and HUD regulations.

- Researched HUD Federal Register notices, HUD handbooks, and the Code of Federal Regulations.

- Researched HUD's monitoring of its program grantee.

- Researched HUD's Disaster Recovery Grant Reporting system.

- Researched the grantee's substantial amendment to the consolidated plan that established its program activities and its policies and procedures for properly administering its program funds.

- Researched the grantee's agreements with its program subgrantees and the monitoring of its subgrantees.

- Interviewed officials of the Birmingham HUD Office of Community Planning and Development, the Alabama Department of Economic and Community Affairs, and its subgrantees.

- Reviewed subgrantees' program records and costs, to include HUD-1 settlement statements, deed restrictions, bank statements, canceled checks, and invoice support for selected program participants.

The review generally covered the period March 2009 through October 2011. We performed the review from October 2011through March 2012 at the offices of the grantee in Montgomery, AL; five of its subgrantees located in Montgomery, Bessemer, Birmingham, Huntsville, and Mobile, AL; and HUD's Office of Community Planning and Development. We adjusted the review period when necessary.

We visited 5 of 11 subgrantees that were responsible for administering the grantee's program. The grantee awarded about $7.2 million of its $37 million NSP1 grant to these five subgrantees. We selected these subgrantees for review because they represented all subgrantees with agreements designed and intended to earn program income.

As of September 30, 2011,

- Subgrantee 1 had been awarded a $2 million grant and earned $383,259 in program income.

- Subgrantee 2 had been awarded a $2 million grant and earned $426,122 in program income.

- Subgrantee 3 had been awarded a $2 million grant and earned about $1.1 million in program income.

- Subgrantee 4 had been awarded a $2 million grant that was later reduced to $475,000 and earned $104,296 in program income.

- Subgrantee 5 had been awarded a $3.5 million grant that was later reduced to $750,000 and earned $5,075 in program income.

We identified and tracked the program income earned for each subgrantee and compared it to draw requests to determine whether the grantee used program income first. We also performed tests to assess whether expenditures were eligible and supported by randomly selecting draw requests of grant funds by each of the five subgrantees. We designed the sample using random, nonstatistical methods to include draw requests from each of the five subgrantees and all of their partnering developers. Because our sampling methods were nonstatistical, the results cannot be projected.

We did not review and assess general and application controls over the grantee's and its subgrantees' information systems. We conducted other tests and procedures to ensure the integrity of computer-processed data that were relevant to the audit objectives. The tests included but were not limited to comparison of computer-processed data to written agreements, contracts, and other supporting documentation. We did not place reliance on the grantee's and its subgrantees' information and used other supporting documentation for the activities reviewed.

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

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.

Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that its resources are used in accordance with laws and regulations.

- Controls over program operations – Policies and procedures that management has implemented to reasonably ensure that management directives are carried out to effectively meet mission goals and objectives.

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 Deficiencies

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

- The grantee lacked internal controls to ensure that program income was identified, tracked, and disbursed before expenditure of grant funds (see finding 1).

- The grantee did not have adequate procedures and controls to ensure that its subgrantees' expenditures were supported (see finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1A		$304,043
2A	$8,540	
Total	$8,540	$304,043

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 the grantee implements recommendation 1A, funds can be used for other eligible activities consistent with HUD requirements.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

OFFICE OF THE GOVERNOR

ROBERT BENTLEY
GOVERNOR

STATE OF ALABAMA

ALABAMA DEPARTMENT OF ECONOMIC AND COMMUNITY AFFAIRS

JIM BYARD, JR.
DIRECTOR

May 3, 2012

Mr. James D. McKay
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Region 4, Office of Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, Georgia 30303-3388

Dear Mr. McKay:

Comment 1

I appreciate the courtesy shown by your staff during their recent audit of the State of Alabama's Neighborhood Stabilization Program (NSP1) authorized under the Housing and Economic Recovery Act of 2008. The State's NSP1 program is implemented by the Alabama Department of Economic and Community Affairs (ADECA). We received your April 23, 2012, Draft Audit Report which indicates this audit was conducted as a result of a hotline complaint. The complaint alleged that the State misused its NSP1 funds by not following the regulations and statutes governing the NSP1 program to ensure it used program funds for eligible and supported purposes. The State deems the complaint to be somewhat ambiguous and unsubstantiated as no specific instances were cited to support the claim nor were any program funds found to be used for ineligible purposes.

Our comments, including specific actions to be taken to address recommendations, appear below.

Finding 1: The Grantee Did Not Disburse Program Income Before Requesting $532,094 of Its Grant Funds.

Recommendations:
1A. Use program income of $532,094, or the current amount available, before drawing additional grant funds from the U.S. Treasury.

Comment 2

Comment: The State allows program income to remain with its subgrantees and requires the subgrantees to report program income received. Consequently, the State

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does not have program income on hand. Prior to HUD's December 3, 2011, Release 7.3 for the Disaster Recovery Grant Reporting (DRGR) system, DRGR allowed for program income data input at the Quarterly Performance Report level only. Therefore, the State reported only program income earned which corresponded to program income expended. Release 7.3 made major changes in the management of program income including the ability to create program income receipts and accounts for organizations that are allowed to retain their program income. While program income was available, any program income understated in reports was due to DRGR constraints at the time. With the implementation of HUD's DRGR upgrade, all program income receipts are now reported. The State will submit supporting documentation to the HUD Birmingham Field Office.

Comment 3

The Audit Report indicates three subgrantees had program income available and did not use it before drawing down additional grant funds. The State has worked with the HUD Birmingham Field Office to either reimburse grant funds from program income amounts with the next draw requests or require the return of NSP1 grant funds. The State will continue to work with the HUD Birmingham Field Office to ensure all available program income has been used before drawing additional grant funds from the U.S. Treasury.

1B. Develop and implement policies and procedures to ensure that the grantee identifies and tracks program income so that it is used before requesting additional cash withdrawals from the U.S. Treasury.

Comment: From the beginning of the NSP1 program, the State utilized a reporting mechanism for program income to be reported and disbursed prior to the disbursement of grant funds. Agreements with the State's subgrantees are dated April 28, 2009. The State's first drawdown form (May 2009) provided for (1) the amount of the draw request to be reduced by program income on the first page and (2) for program income receipts to be reported under "*Income (Sales/Rental)*" on Attachment #1. The next revision of the drawdown form (January 2010) continued to provide for (1) the amount of the draw request to be reduced by program income on the first page, (2) changed Attachment #1 to reflect the property disposition type (sold or leased) and (3) added Attachment #2 to provide more detailed information on program income receipts and expenditures.

Under the NSP1 program, HUD has issued 2 Policy Alerts concerning program income. The first Alert, *Program Income in the Neighborhood Stabilization Program, July 13, 2011*, was received by the State on July 13, 2011, and e-mailed to NSP1 subgrantees on July 15, 2011. The second Alert, *Updated Guidance on Meeting the 25% Set-Aside Requirement, September 1, 2011*, was received by the State on September 6, 2011, and e-mailed to NSP1 subgrantees on September 7, 2011. On October 19, 2011, the State hosted a conference call for its NSP1 subgrantees. Among the topics discussed were reminders that, upon receipt, program income should be immediately reported to the State and program income must be expended prior to requesting NSP1 grant funds.

Additionally, the State conducted individual technical assistance meetings with two subgrantees to review program income requirements.

Comment 3

On December 2, 2011, the State e-mailed a new "*NSP Receipt of Program Income Report*" to its subgrantees and requested this report be submitted on a monthly basis beginning with program income received during the month of November 2011. Subgrantees were advised to report program income received from property sales within 3 business days of the HUD-1 settlement date and to report program income received from property rentals, lease-purchase, and/or mortgage payments on a monthly basis. In the event no program income was received during a calendar month, subgrantees were advised to submit a monthly report indicating no program income was received. This report is to be submitted to the State immediately upon receipt of program income from property sales and no later than the 10th day of the month following the month other program income is received. This report includes a certification statement whereby the subgrantee certifies that no request for NSP1 grant funds has been submitted prior to the expenditure of program income funds. This monthly reporting requirement is in addition to the drawdown reporting which has been required since the beginning of the program. Since implementing this requirement, the State has received monthly reports from all subgrantees generating program income.

The State also requires its subgrantees to submit a "*Quarterly Progress Report*". Beginning with the quarter ending December 31, 2011, the State modified this report to provide for more accurate disclosure of homes sold or leased during the quarter. The State will submit documentation supporting these actions to the HUD Birmingham Field Office.

HUD has not issued closeout guidance for the NSP1 grant or NSP1 program income. When this guidance is received, the State will relay the instructions to its subgrantees as it has relayed all previous guidance.

1C. Reconcile the Disaster Recovery Grant Reporting system to accurately reflect the grantee's use of its grant funds and program income.

Comment 3

As a result of HUD's December 3, 2011, Release 7.3 for the Disaster Recovery Grant Reporting (DRGR) system, the State's grant funds and program income are accurately reflected. The State will submit supporting documentation to the HUD Birmingham Field Office.

Finding 2: The Grantee Did Not Ensure That Program Fund Expenditures Were Adequately Supported.

Recommendations:
2A. Provide supporting documentation for the $8,540 charged to its program or repay the U.S. Treasury account from non-Federal funds the amount that it cannot support.

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Comment 3

Comment: The audit revealed that unsupported costs in the amount of $8,540 were charged to the program. State staff worked with the identified subgrantee and located and provided support for $6,175 after the auditors left the subgrantee site. The State has verified that this $6,175 was not paid in other draws and will submit the supporting documentation to the HUD Birmingham Field Office. The State will continue to work with the subgrantee to provide support for the remaining $2,365. In the event costs are found to be unsupported, the State will require the subgrantee to repay any unsupported costs with non-Federal funds.

2B. Develop and implement policies and procedures for its disbursement review and approval process.

Comment 4

Comment: The NSP1 program is operating under onerous deadlines. As stated in the Audit Report, the State did not want to risk impeding the program's progress by slowing down draw requests. Instead, the State tests expenditures during onsite monitoring. The Audit Report indicates this procedure is problematic because draws made after the monitoring review were not verified. While this is an accurate statement for this point in time, the NSP1 program is not complete. The State anticipates conducting additional monitoring prior to program close-out. Obviously, the State cannot review every item of supporting documentation because program progress would halt and the cost would be too high. The very nature of "testing" allows the State to sample a significant number of documents to verify expenditures are accurate and program related. The Audit Report itself supports this process as less than .006 percent of expenditures are in question. The State believes its disbursement review and approval process ensures adequate support of expenditures. The State will work with the HUD Birmingham Field Office to determine whether or not additional procedures are necessary.

In closing, I would like to thank you for the professionalism shown by your staff during the audit. They gave genuine consideration to the questions and concerns of my staff and those of our subgrantees. They remained accessible and available throughout the audit.

We trust the Office of Inspector General appreciates the challenges of administering a program which has been continually evolving since its inception. For the NSP1 program alone, the State has participated in over 100 HUD sponsored webinars, implemented approximately 45 HUD Policy Alerts, and attended 7 HUD sponsored trainings. The State has a long history of effectively administering Community Development Block Grant programs and will continue to ensure its subgrantees remain in compliance with Neighborhood Stabilization Program requirements established by HUD. As requested, the State will work with the Director for Community Planning and Development in the HUD Birmingham Field Office to implement the recommendations contained in the Audit Report.

Mr. James D. McKay
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If you have any questions, please contact Mr. Shabbir Olia at (334) 242-5468.

Sincerely,

Jim Byard, Jr.
Director

JB:SJD

c: Ms. Sonya D. Lucas, Assistant Regional Inspector General for Audit
Mr. Robert W. Burgess, Senior Auditor
Office of Inspector General, Region 4
Mr. Charles Franklin, CPD Director, U.S. Department of Housing and Urban Development, Birmingham Office Region IV

OIG Evaluation of Auditee Comments

Comment 1 The hotline complaint was partially substantiated by the results in Findings 1 and 2. Finding 1 showed that the grantee disbursed $304,043 from its grant to pay for program costs when program income was available for use. Finding 2 disclosed that $8,540 was disbursed for unsupported expenditures.

Comment 2 While HUD's upgrade did make changes to reporting program income, the grantees have always been able to report program income expended in their quarterly performance reports. The new upgrade allowed the grantee to use a "RECEIPT" function to identify each program income transaction rather than recording amounts quarterly. The grantee should have their own internal accounting system, to make sure program income is spent before drawing down grant funds.

Comment 3 The comments indicate the grantee's responsiveness and willingness to implement corrective actions by either supporting or repaying the unsupported costs.

Comment 4 The grantee's comments are responsive to improved procedures for its disbursement review and approval process. The grantee's procedures lacked the ability to test the expenses before draws were approved because it did not require its subgrantees to submit any supporting documents. The comment to conduct additional monitoring to include testing a significant number of expenses prior to program close-out, shows its willingness to better assure that program expenses are supported and eligible.

Our selection of expenses for testing was non-statistical and the audit results cannot be projected; therefore, it is incorrect for the grantee to project only .006 percent of expenditures are in question.