



State of Connecticut

Neighborhood Stabilization Program



To: Alanna Kabel
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From: //SIGNED//
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Subject: The State of Connecticut Did Not Always Administer Its Neighborhood Stabilization Program in Compliance With HUD Regulations

Attached are the U.S. Department of Housing and Urban Development (HUD) Office of Inspector General's (OIG) final results of our review of the State of Connecticut's administration of its Neighborhood Stabilization Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to contact John Harrison, Acting Assistant Regional Inspector General for Audit, at 212-264-4174, or me at 617-994-8380.



Audit Report Number: 2016-BO-1003

Date: June 28, 2016

The State of Connecticut Did Not Always Administer Its Neighborhood Stabilization Program in Compliance With HUD Regulations

Highlights

What We Audited and Why

We audited the State of Connecticut's Neighborhood Stabilization Program (NSP) based on the amount of NSP1 funding received. The State received more than \$25 million in NSP1 funds in program year 2009, making it the second highest funded State in New England, and had not recently been audited by the Office of Inspector General. Our overall audit objective was to determine whether State officials administered the State's NSP in accordance with U.S. Department of Housing and Urban Development (HUD) program regulations.

What We Found

State officials did not always administer the State's NSP in accordance with program regulations. Specifically, they did not always ensure that (1) costs were eligible, reasonable, and supported; (2) national objectives were met; (3) proper affordability restrictions were in place; (4) properties were acquired at a discount; and (5) program income was properly administered. These deficiencies occurred because State officials did not provide adequate oversight of their subrecipients to ensure that they administered NSP funds in accordance with program regulations. As a result, the State incurred \$670,778 in ineligible costs, \$29,106 in unreasonable costs, more than \$2 million in unsupported costs, and \$212,496 in program income that was not accounted for and returned to the State by the subrecipient, which could be reallocated to other eligible NSP activities.

What We Recommend

We recommend that the Director of HUD's Hartford Office of Community Planning and Development require State officials to (1) repay \$670,778 in ineligible costs, (2) justify or repay \$29,106 in unreasonable costs, (3) provide adequate documentation to support the eligibility of or repay more than \$2 million in NSP costs, (4) provide support to show that \$212,496 in program funds have been remitted and reallocated to eligible NSP activities, (5) amend the affordability restrictions in place for five properties, and (6) strengthen controls over subrecipient monitoring to provide greater assurance that NSP funds will be properly administered.

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Background and Objective

The Neighborhood Stabilization Program (NSP), authorized under Title III of the Housing and Economic Recovery Act of 2008, was established for the purpose of stabilizing communities that suffered from foreclosures and abandonment. In 2008, the U.S. Department of Housing and Urban Development (HUD) allocated \$3.92 billion for NSP¹ on a formula basis to States, territories, and local governments. The goal of NSP1 was to purchase and redevelop foreclosed-upon and abandoned homes and residential properties. The funding was provided through HUD's Community Development Block Grant (CDBG) program. NSP1 provided grants to every State, certain local communities, and other organizations to purchase foreclosed-upon or abandoned homes and rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stop the decline in value of neighboring homes.

On March 9, 2009, HUD awarded the State of Connecticut \$25 million in NSP1 funds. The State's Office of Housing, which was responsible for administering its NSP, awarded \$24.4 million, including administrative funds, to 10 subrecipients to administer the program.

According to the State's revised NSP substantial amendment, dated September 1, 2010, which outlined the State's planned uses for the NSP1 funding, the State planned to use NSP funds for the following types of activities.

- Establishing financing mechanisms for purchase and redevelopment of foreclosed-upon homes and residential properties, including subsidized second mortgages, loan loss reserves, and shared equity loans for low- and moderate-income home buyers;
- Purchasing and rehabilitating homes and residential properties that have been abandoned or foreclosed upon to sell, rent, or redevelop such homes and properties;
- Demolishing blighted structures and redeveloping demolished or vacant properties; and
- Redeveloping demolished or vacant properties.

The audit objective was to determine whether the State, through its subrecipients, properly administered its NSP in accordance with HUD regulations. Specifically, we wanted to determine whether NSP funds were spent for eligible activities and costs that were eligible and supported.

¹ Congress appropriated a second round of NSP funding (NSP2) totaling \$1.93 billion under the American Recovery and Reinvestment Act of 2009 and a third round (NSP3) totaling \$1 billion under Section 1497 of the Wall Street Reform and Consumer Protection Act of 2010. The State of Connecticut did not receive any NSP2 funds but did receive NSP3 funds. This report addresses only NSP1 funding.

Results of Audit

Finding 1: State Officials Did Not Always Administer the State's NSP in Accordance With HUD Regulations

State officials did not always administer the State's NSP in accordance with program regulations. Specifically, they did not always ensure that (1) costs were eligible, reasonable, and supported; (2) national objectives were met; (3) proper affordability restrictions were in place; (4) properties were acquired at a discount; and (5) program income was properly administered. These deficiencies occurred because State officials did not provide adequate monitoring and oversight of their subrecipients to ensure that they followed NSP requirements and had implemented adequate policies and procedures. As a result, the State incurred \$670,778 in ineligible costs, \$29,106 in unreasonable costs, more than \$2 million in unsupported costs, and \$212,496 in program income that was not remitted by the subrecipient, which could be reallocated to other eligible NSP activities (appendix C).

Costs Were Not Always Eligible, Reasonable, or Adequately Supported

State officials did not ensure that subrecipient acquisition, rehabilitation, and administrative costs were always eligible, reasonable, or adequately supported. The Office of Management and Budget cost principles at 2 CFR (Code of Federal Regulations) Part 225, appendix A, paragraph (C)(1)(j), require NSP grantees and their subrecipients to ensure that all costs incurred are adequately documented, and paragraph (C)(1)(a) requires that grantees and their subrecipients ensure that all costs incurred are reasonable and necessary for proper and efficient performance and administration of Federal awards. The State was not able to support that more than \$2.8 million in NSP funds disbursed was eligible, reasonable, and supported.

Funds Disbursed for Ineligible and Unreasonable Costs

Officials disbursed \$666,668 for ineligible² and \$29,106 for unreasonable costs for nine properties:

-- \$604,331 was disbursed for costs that were not eligible because the subrecipient committed NSP funds prior to completing an environmental review determination for this property. The environmental review was completed after the property was acquired and rehabilitation work was almost completed, and the documentation for the review was inadequate to determine that environmental requirements had been met, contrary to regulations at 24 CFR 570.200(a)(4) and Part 58. Further, the subrecipient paid the developer for acquisition and some rehabilitation costs incurred before there was a written agreement in place.

² Ineligible costs of \$4,110 were questioned under the section, Properties Not Acquired at a Discount.

- \$4,000 was disbursed for costs that were also paid by another Federal program.
- \$4,193 was paid for duplicate items or services paid with NSP funds and costs paid that should have been part of the developer fee.
- \$54,144 in ineligible costs was paid for four properties where the developer did not fully perform on the contract.³
- \$29,106⁴ in unreasonable costs was paid to a developer for a 15 percent acquisition fee on the property, while the typical acquisition fee for other developers was 3 percent for this subrecipient. State officials said the higher percentage was reasonable because they did not want to penalize developers that purchased properties needing only a small amount of rehabilitation.

Funds Disbursed for Inadequately Supported Costs

Subrecipient staff did not always document that costs of more than \$1.8 million were supported for 14 properties and the State paid \$123,108 in unsupported administrative fees to two developers. Specifically, the files did not always include (1) the scope of work, cost estimates, and a review of cost reasonableness; (2) initial, progress, or final inspections; and (3) adequate support for all NSP funds requisitioned. An initial inspection of the property was necessary to show what work was required, a cost estimate or cost reasonableness review was necessary before awarding the NSP funds, and progress or final inspections of the work performed were necessary to document that the repairs were made and met NSP requirements. Regulations at 2 CFR Part 225, appendix A, paragraph (C)(1)(a), require NSP grantees and their subrecipients to ensure that all costs are necessary and reasonable for proper and efficient performance and administration of Federal awards, and (C)(1)(e) requires that costs be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the government unit. Additionally, 24 CFR Part 85.36, "Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments," requires grantees to perform a cost or price analysis for every procurement action, including contract modifications.

One subrecipient included a fixed 15 percent project delivery cost totaling \$45,576 for two properties with no documentation showing the basis for the percentage. Office of Management and Budget cost principles at 2 CFR Part 225, appendix A, paragraph (C)(1)(j), require NSP grantees and their subrecipients to ensure that all costs incurred are adequately documented.

³ We questioned costs paid for these four properties, such as attorney fees, design and development costs, zoning, and insurance. Invoices were billed for all seven properties at times; therefore, we calculated the costs attributable to the four properties if the invoice was not specific to the property. The developer did not perform on the contract for these properties; however, the costs related to these properties were charged against the three other properties that were partially completed by the developer in our sample. Therefore, we prorated the ineligible costs evenly to the three properties in our sample.

⁴ This is the amount paid above the customary 3 percent acquisition fee.

According to subrecipient officials, that is what they charged for all of their activities, and it was not based on actual time spent on the activity.

In another case, while the subrecipient was provided \$272,492, the file lacked documentation for an initial inspection to show what work was necessary, a cost estimate or other documentation showing that the subrecipient had reviewed the costs for reasonableness, and progress inspections. While the file included some emails regarding inspections, there was only one documented inspection report in the file relating to rehabilitation work and one to address deficiencies cited by the home buyer's inspection report. The developer also put the property up for sale before completing the work, and the home buyer's inspection report identified several deficiencies with the condition of the property, completeness of work, and workmanship. Additionally, the subrecipient went significantly over budget for this property without justification; \$272,492 was disbursed for this property, while the initial NSP budget according to the developer agreement was \$135,775. While a subrecipient official attributed the cost overruns partially to vandalism, there was no support showing vandalism at the property. According to the subrecipient official, the developer did not file a police report or an insurance claim for the damage and loss, which would have ensured that insurance proceeds would have paid for some of the costs in accordance with the developer contract and subrecipient agreement with the State.

In some cases, the subrecipients obtained missing documentation from the developers and provided it to us for review, and while one subrecipient did not maintain NSP files for five properties reviewed, some documents were located on a subrecipient official's computer.

The State also paid \$123,108 in unsupported administrative fees to two developers. Specifically, one of the State's subrecipients paid two developers both an administrative and a developer fee for the properties that they acquired and in some cases rehabilitated. The subrecipient executed subrecipient agreements with the developers, which provided for payment of both fees. While the subrecipient official said the developers provided other services, such as acquiring the properties and providing financing, they were paid an acquisition fee for this service, the financing was not NSP funded, and a separate agreement should have been executed if the developer provided other NSP services to the subrecipient. NSP Policy Alert, Guidance on the Procurement of Developers and Subrecipients, dated June 1, 2012, provides that when selecting a nonprofit as a partner, a grantee must decide whether the nonprofit will be treated as a subrecipient, a developer, or both, in which case separate agreements must be executed. Costs must be tracked carefully, and developer fees cannot be assessed on services provided as a subrecipient.

Achievement of a National Objective Was Not Ensured

State officials did not ensure that their subrecipients supported that six activities met a national objective. We questioned \$254,183⁵ provided to five⁶ properties as unsupported costs because

⁵ To not double count questioned costs, we did not include \$863,247 in costs related to this deficiency here as we questioned the costs in the section, Costs Were Not Always Eligible, Reasonable, or Adequately Supported.

⁶ Four of the five properties had not been completed by one subrecipient.

the properties were not completed within the timeframe stipulated in the subrecipient agreement and to a sixth property for which beneficiary information was not adequate to ensure that the home buyer was income eligible. We attributed these deficiencies to inadequate oversight by both State and subrecipient officials and a lack of follow-up by subrecipient officials when inadequate information was provided by the home buyer. As a result, it was uncertain whether these assisted properties would meet a national objective.

A subrecipient executed a contract with a developer in August 2010 to complete seven modular home-ownership units by September 2012 and then amended the contract in February 2011 to extend completion to December 2012. However, the developer experienced difficulty in meeting the expected performance so the subrecipient adjusted the budget in August 2012 and reduced the number of properties to three but did not change the completion date. As of March 2015, the developer had not completed and sold the three properties. We performed a subsequent inspection in March 2016, and found the properties were still not completed and one property (pictured below) appeared to have mold covering the ceiling and walls.



76 White Street, Bridgeport, CT

The subrecipient also provided NSP funds to another developer for a fourth property (pictured on the next page) in August 2012 to stabilize it, but it was boarded up at the time of our review. Therefore, we regarded the \$104,882 disbursed for this property as an unsupported cost.



NSP funds used to stabilize property at 354 and 360 Main Street, Bridgeport, CT

Another subrecipient provided funds to a developer to demolish a house and put in a parking lot (pictured on the next page), but a parking lot was determined not to be feasible due to the grading of the land. Therefore, with subrecipient approval, the developer transferred the property in November 2013 to another developer, which intended to build a two-family home on the land. While the deed provided that the grantee would promptly begin improvements and construction would begin within 30 days, the lot was vacant at the time of our review, a year and a half later. The subrecipient stated that the developer would not start the construction until it had an eligible home buyer for the property. Therefore, we regarded the \$50,828 disbursed for this property as an unsupported cost.



Vacant lot at 384 Blatchley Avenue, New Haven, CT, without activity after a year and a half

The State's action plan substantial amendment, dated December 1, 2008,⁷ and the subrecipient agreements required that funds be spent for 100 percent of the activities within 720 days and 100 percent of units be occupied or sold within 900 days of the subrecipient agreements.⁸

In addition, family income information in the file for an assisted home buyer was inconsistent, and the subrecipient did not obtain additional information to ensure the eligibility of the home buyer. The Housing and Economic Recovery Act of 2008, section 2301(f)(3), requires that all funds appropriated or otherwise made available under this section be used with respect to individuals and families whose income does not exceed 120 percent of area median income (\$69,100). However, information in the file was not adequate to support that the home buyer's income did not exceed the median income limit. We questioned \$98,473 disbursed for this property as an unsupported cost.⁹

⁷ Amended September 1, 2010

⁸ The subrecipient agreements for the incomplete properties were dated May 29, 2009, and April 15, 2009.

⁹ State officials disbursed \$273,100 for this property, of which \$147,462 was paid back in program income. Therefore, we reduced the amount of questioned costs to \$125,638. Of this amount, \$98,473 was questioned here, and \$27,165 was questioned under the section, Costs Were Not Always Eligible, Reasonable, or Adequately Supported, for unsupported project delivery costs.

Proper Affordability Restrictions Were Not Always Put Into Place

State officials did not always ensure that their subrecipients adequately documented that the proper affordability restrictions were in place for five properties reviewed. The State adopted the HOME Investment Partnerships Program standards at 24 CFR 92.252(a), (c), (e), and (f) and 92.254 (Affordable Rents and Continued Affordability) as a minimal standard for any unit acquired or rehabilitated with NSP resources, which required that assisted housing meet the affordability requirements for not less than the applicable period beginning after project completion. However, in two cases, one subrecipient did not ensure that the affordability restriction covered the required affordability period. Specifically, the subrecipient provided that the affordability period would begin when the developer executed the declaration of land use restrictive covenant rather than when the property was occupied, which was more than 2½ years before the property was sold and occupied by an income-eligible home buyer. In another two cases, the subrecipient did not specify what the income limits would be for the rental units. In a fifth case, involving a home-ownership and rental unit assisted property, the subrecipient used a declaration of land use restrictive covenant for home-ownership housing without rentals. Therefore, the home buyer had not provided the lease and income information for the tenant to the subrecipient.¹⁰ We attributed this deficiency to inadequate monitoring by State officials. As a result, more than \$1.2 million in NSP funds was invested in five properties, which were at risk of not remaining affordable for the entire affordability period required.

Properties Were Not Acquired at a Discount

State officials did not ensure that two properties acquired with NSP funds were purchased at the required discount. The Housing and Economic Recovery Act of 2008, section 2301(d)(1), provides that any purchase of a foreclosed-upon home or residential property must be at a discount from the current market appraised value, taking into account its current condition, and such discount must ensure that purchasers pay below market value for the property. Federal Register 74 FR 29225 (June 19, 2009), requires the discount to be at least 1 percent from the current market appraised value. We attributed this overpayment to subrecipient officials' unfamiliarity with HUD regulations and inadequate monitoring by the State. As a result, \$4,110, the amount above the 1 percent discount, was an ineligible use of NSP funds. The address, appraised value, purchase offer amount, and discount amount of each property purchased must be documented in the grantee's program records.

Program Income Was Not Properly Administered

The developer for one subrecipient, which developed three properties, had not remitted approximately \$212,496 in program income upon the sale of the properties. The agreement between the State and the subrecipient required that all program income derived from eligible activities funded with NSP funds be remitted to the State upon receipt. Program income, which may be reallocated to a municipality at the discretion of the State, may be used only for eligible NSP activities in accordance with 73 FR 58330 (October 6, 2008). The three properties were

¹⁰ At our request, the subrecipient obtained the current tenant information from the home buyer, including the lease and income information, to show that the current tenant was income eligible.

sold by the developer in June and September 2012 and November 2014. The program income had not been remitted by the developer to the subrecipient as of June 30, 2015; however, the State provided additional documentation on August 21, 2015, showing that the developer had remitted \$107,496 in program income to the subrecipient for two of the three properties on August 6, 2015. This condition occurred because the State did not enforce its agreement with the subrecipient when the program income was not accounted for and returned to the State as required. Therefore, the \$212,496 in program income funds should be returned to the State and reallocated to eligible NSP activities.

State Officials Did Not Provide Adequate Oversight and Monitoring of Their Subrecipients

The State delegated the administration of its NSP allocation¹¹ to 10 subrecipients but remained accountable for the administration and monitoring of those funds. HUD has developed various guidebooks to assist grantees with grant administration, and HUD's Managing CDBG: A Guidebook for Grantees on Subrecipient Oversight provides grantees, such as the State, with detailed information "for the major steps in selecting, training, managing, monitoring and supporting subrecipients" and notes that "together, these elements constitute the basic components of a subrecipient oversight system." However, State officials performed limited monitoring and oversight of their subrecipients.

According to the Guidebook, "Monitoring should not be a 'one-time event.' To be an effective tool for avoiding problems and improving performance, monitoring must involve an on-going process of planning, implementation, communication, and follow-up." However, State officials did not adequately monitor their subrecipients to ensure that they followed program rules and regulations. Based on the monitoring letters provided by State officials, the State performed an onsite monitoring review of its subrecipients once during our review period. For two subrecipients, there was no monitoring letter regarding the results of their review. One of the subrecipients that did not receive a monitoring report from State officials had significant deficiencies for the properties reviewed and with its record keeping. It appeared that an onsite review had been performed as there were checklists in the file, but the State did not provide written results to the subrecipient. Based on a follow-up letter from HUD to the State, the State indicated that there were no findings for these two properties.

Additionally, our review of one subrecipient's monitoring file of its quarterly performance reports did not show a documented review. State officials said that they may have communicated verbally or through email, but emails were not included in the file.

During HUD's monitoring of the State in March 2012, HUD concluded that the State had not conducted appropriate reviews and audits of its NSP as required and had not maintained accurate or timely records of overall grant performance in the Disaster Recovery Grant Reporting¹²

¹¹ Excluding administrative costs

¹² The Disaster Recovery Grant Reporting system was developed by HUD's Office of Community Planning and Development for the CDBG Disaster Recovery program and other special appropriations such as NSP. Data from the system are used by HUD staff to review activities funded under these programs and for required quarterly reports to Congress.

system as required. HUD attributed the deficiencies to the State's failure to dedicate adequate staff resources to administering its NSP. State officials told us that the deficiencies identified were also a result of high turnover, layoffs, consolidation and reorganization of departments, leadership changes, and changes to NSP program rules throughout this period. However, they and HUD officials said that the State had entered information for the quarterly performance reports and made necessary corrections.

Conclusion

State officials did not ensure that the State's NSP was always administered in accordance with program regulations. We attributed these deficiencies to the State's not implementing adequate oversight controls and monitoring sufficient to ensure compliance with all applicable regulations. As a result, the State incurred \$670,778 in ineligible costs, \$29,106 in unreasonable costs, more than \$2 million in unsupported costs, and \$212,496 in program income that was not remitted by the subrecipient, which could be reallocated to other eligible NSP activities.

Recommendations

We recommend that the Director of HUD's Connecticut Office of Community Planning and Development instruct State officials to

- 1A. Repay to the Treasury from non-Federal funds the \$666,668 in NSP funds spent for ineligible activity costs and funds that had already been paid by another Federal program.
- 1B. Justify the reasonableness of or repay to the Treasury from non-Federal funds the \$29,106 in NSP funds spent for unreasonable activity costs.
- 1C. Provide documentation to support that \$1,807,359 in NSP funds was spent for reasonable, necessary, and supported costs. Any amount for which adequate support cannot be provided should be repaid to the Treasury from non-Federal funds.
- 1D. Provide documentation that \$123,108 in NSP funds paid to two developers for administrative expenses was supported and that work performed was completed in accordance with their contracts. Any amount for which adequate support cannot be provided should be repaid to the Treasury from non-Federal funds.
- 1E. Strengthen the State's financial controls to provide greater assurance that NSP funds are used for eligible and reasonable costs.
- 1F. Strengthen controls to ensure that environmental review assessments are completed in accordance with regulations at 24 CFR 570.200(a)(4) and Part 58.
- 1G. Provide a plan for the completion within acceptable timeframes of the five unfinished properties or cancel the activities and deobligate and reprogram the \$254,183 in funds to other allowable activities, thus ensuring that the funds will be put to their intended use.

- 1H. Amend the affordability restrictions in place for the five properties for which the affordability restrictions were not adequate, thus ensuring that HUD's interest in the properties is protected and the funds allocated to these properties will be put to their intended use.
- 1I. Strengthen controls over the enforcement of affordability restrictions to ensure that HUD's interest in NSP-assisted properties is protected.
- 1J. Repay to the Treasury from non-Federal funds the \$4,110 disbursed for properties in excess of the required discount.
- 1K. Strengthen controls over property purchases to ensure that properties are acquired at the applicable discount.
- 1L. Provide support showing that \$212,496 in program funds was remitted to the State and reallocated to eligible NSP activities and that any additional program income owed by the developer has been remitted.
- 1M. Strengthen controls over the administration of program income to ensure that it is properly accounted for and disbursed before drawing down funds from the program line of credit.
- 1N. Strengthen controls over monitoring and oversight of its subrecipients to ensure that they comply with their agreements and program requirements.

Scope and Methodology

The audit focused on whether State officials established and implemented adequate controls to ensure that the State's NSP was administered in accordance with program requirements. We performed the audit fieldwork from November to July 2015 at the State's Office of Housing, 505 Hudson Street, Hartford, CT, and at 7 of the 10 subrecipient offices. Our audit covered the period March 2009 through March 2013 and was extended when necessary to meet our audit objective.

To accomplish our objective, we

- Reviewed applicable laws, regulations, HUD handbooks, HUD notices, and State and subrecipient policies and procedures.
- Conducted discussions with State and subrecipient officials to gain an understanding of the organizational structure and administration of the State's NSP.
- Conducted discussions with HUD.
- Reviewed records of independent public auditors' reports and monitoring reviews of the State's subrecipients performed by the State and a HUD monitoring review of the State.
- Reviewed the State's substantial amendment, grant agreement executed between HUD and the State for the NSP funds, and subrecipient agreements.
- Reviewed various Disaster Recovery Grant Reporting system reports to document the State's activities and disbursements. Our assessment of the reliability of the data in this system was limited to data reviewed and reconciled with State records. Therefore, we did not assess the reliability of this system. However, the data were sufficiently reliable for our purposes.
- Selected a sample of 24 NSP-assisted properties from a universe of 83 assisted properties during the audit period for which more than \$6.9 million was committed, representing 39 percent of the more than \$17.8 million obligated by the State, to test for compliance with HUD regulations. Specifically, we tested whether (1) the activity met a national objective, was in an eligible target area, was purchased at the required 1 percent discount, and had the proper affordability restrictions in place; (2) the State supported the necessity and reasonableness of costs; (3) the resale price was

set in accordance with requirements and the rental price was affordable; and (4) program income was properly administered. These properties were selected based on risk that considered the potential payment of both administrative and developer fees,¹³ for-profit developers, uncompleted projects, and higher dollar rehabilitation costs per unit. Our results apply to the sample and cannot be projected to the universe.

- Performed a limited review of another five NSP rehabilitation properties, with an authorized amount of \$771,894 to determine whether the subrecipients supported that they met a national objective, program income was remitted and reported to the State, or the property was purchased with the required purchase price discount.
- Performed a limited inspection of 29 activities in our sample to determine the condition of the properties.

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

¹³ Our review of administrative costs was limited to one subrecipient that paid administrative costs to two developers.

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:

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

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 State did not have adequate controls over efficiency and effectiveness of program operations when officials did not adequately monitor and oversee the State's subrecipients to ensure that they followed NSP requirements and had implemented adequate policies and procedures (finding).
- The State did not have adequate controls over the reliability of financial data when officials did not establish adequate financial controls to ensure that the requisitions for funds were adequately supported and costs were eligible, necessary, and reasonable (finding).
- The State did not have adequate controls over compliance with laws and regulations when officials did not always comply with HUD regulations to ensure that activities met a national objective, the purchase price discount was properly supported, and the environmental review was performed in a timely manner (finding).
- The State did not have an adequate system to ensure that resources were properly safeguarded when officials did not always ensure that the proper affordability restrictions were put into place and program income was accounted for and returned as required (finding).

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Ineligible 1/	Unsupported 2/	Unreasonable or unnecessary 3/	Funds to be put to better use 4/
1A.	\$666,668			
1B.			\$29,106	
1C.		\$1,807,359		
1D.		123,108		
1G.		254,183		
1J.	4,110			
1L.				\$212,496
Totals	670,778	2,184,650	29,106	212,496

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ 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.
- 3/ Unreasonable or unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ 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 pre-award reviews, and any other savings that are specifically identified. In this instance, if the State implements our recommendation to recover \$212,496 in program income, it can assure HUD that these funds will be available for other NSP activities and put to better use.


Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation


Auditee Comments

Comment 1



Dannel P. Malloy
Governor

STATE OF CONNECTICUT
DEPARTMENT OF HOUSING



Evonne M. Klein
Commissioner

April 22, 2016

██████████
U.S. Department of Housing and Urban Development
Office of Inspector General
20 Church Street, One Corporate Center
Hartford, CT 06103-3220

RE: Response to Draft Audit 2016-BO-100X

Dear ██████████:

Thank you for the opportunity to meet with you and the other U.S. Department of Housing and Urban Development (HUD) staff to discuss the Draft Audit on the State of Connecticut Neighborhood Stabilization Program (NSP). As was discussed at the meeting on April 18, 2016, the Department has a number of concerns with regard to the Draft Audit, and has developed the following comments, most of which were discussed with you and your staff either during the audit period, or at the meeting on the 18th.

I have summarized our position with regard to the specific recommendations below, and then have addressed each of the specific issues identified by the draft in an accompanying attachment.

Recommendation:

1A. Repay to the Treasury from non-Federal funds the \$666,668 in NSP funds spent for ineligible activity costs and funds that had already been paid by another Federal program.

Response:
The Department disagrees with the finding and the recommendation.

Recommendation:

1B. Justify the reasonableness of or repay to the Treasury from non-Federal funds the \$29,106 in NSP funds spent for unreasonable activity costs.

Response:
The Department disagrees with the finding and the recommendation.

Recommendation:

1C. Repay to the Treasury from non-Federal funds \$123,108 in NSP funds for ineligible administrative expenses paid to two developers.

Response:
The Department disagrees with the finding and the recommendation.

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**Ref to OIG
Evaluation**

Auditee Comments

Recommendation:

1D. Provide documentation to support that \$1,807,359 in NSP funds was spent for reasonable, necessary, and supported costs. Any amount for which adequate support cannot be provided should be repaid to the Treasury from non-Federal funds.

Response:

The Department disagrees with the finding and the recommendation.

Recommendation:

1E. Strengthen the State's financial controls to provide greater assurance that NSP funds are used for eligible and reasonable costs.

Response:

The Department agrees with the recommendation.

Recommendation:

1F. Strengthen controls to ensure that environmental review assessments are completed in accordance with regulations at 24 CFR 570.200(a)(4) and Part 58.

Response:

The Department agrees with the recommendation.

Recommendation:

1G. Provide a plan for the completion within acceptable timeframes of the five unfinished properties or cancel the activities and deobligate and reprogram the \$254,183 in funds to other allowable activities, thus ensuring that the funds will be put to their intended use.

Response:

The Department agrees with the recommendation.

Recommendation:

1H. Amend the affordability restrictions in place for the five properties for which the affordability restrictions were not adequate, thus ensuring that HUD's interest in the properties is protected and the funds allocated to these properties will be put to their intended use.

Response:

The Department agrees with the recommendation.

Recommendation:

1I. Strengthen controls over the enforcement of affordability restrictions to ensure that HUD's interest in NSP-assisted properties is protected.

Response:

The Department agrees with the recommendation.

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Auditee Comments

Recommendation:

IJ. Repay to the Treasury the \$4,110 disbursed for properties in excess of the required discount.

Response:

The Department agrees with the recommendation and will seek recovery from the Grantee.

Recommendation:

IK. Strengthen controls over property purchases to ensure that properties are acquired at the applicable discount.

Response:

The Department agrees with the recommendation.

Recommendation:

IM. Provide support showing that \$212,496 in program funds was remitted to the State and that any additional program income owed by the developer has been remitted.

Response:

As provided as supporting documents at our April 18th meeting, \$204,323.25 of these funds have been recovered as program income, and the grantee community and the developer are currently at odds over the remainder. The Department will continue to work with the grantee community to address the remaining balance, either as documented legitimate expenditures, or through recovery of program income.

Recommendation:

IN. Strengthen controls over the administration of program income to ensure that it is properly accounted for and disbursed before drawing down funds from the program line of credit.

Response:

The Department agrees with the recommendation.

Recommendation:

IO. Strengthen controls over the amendment of action plans to ensure that proposed changes are subject to public and HUD review as required.

Response:

The Department disagrees with the finding and the recommendation.

Recommendation:

IP. Strengthen controls over monitoring and oversight of its subrecipients to ensure that they comply with their agreements and program requirements.

Response:

The Department agrees with the recommendation.

**Ref to OIG
Evaluation**

Auditee Comments

Comment 2

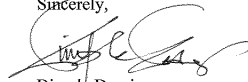
Comment 1

Please note that I have taken the liberty of eliminating Recommendation 1L, as it was duplicative of Recommendation 1K.

In addition, the Draft Audit identified four (4) significant deficiencies which appear to be directly related to the Findings above. The Department disagrees with these items being characterized as significant deficiencies, as further described in the attachment.

Again, I would like thank you for the opportunity to comment on the Draft Audit, and for your continued assistance in the effective implementation of this federal grant program. Should you have any questions, or require additional information, please do not hesitate to contact me.

Sincerely,



Dimple Desai
Director
Office of Small Cities-Community Development Block Grant
And Technical Services

Cc: Ms. Alanna Kabel, Director, Hartford Field Office, CPD, 1ED
Edward Jeye, Regional Inspector General for Audit, Boston, Region 1
Mr. Clifford Taffet, General Deputy Assistant Secretary, Washington, DC, CPD, D
Evonne M. Klein, Commissioner, DOH

Attachment

**Ref to OIG
Evaluation**

Auditee Comments

Comment 3

Response to Draft Audit – State of Connecticut Neighborhood Stabilization Program

Funds Disbursed for Ineligible and Unreasonable Costs – Disagree (1A, 1B, 1C, 1E, 1F)

Officials disbursed \$666,668 for ineligible and \$29,106 for unreasonable costs for nine properties and another \$123,108 in ineligible administrative fees to two developers.

-- \$604,331 – Audit purports that developer was paid for acquisition and rehabilitation costs incurred for a property before a written agreement with the developer was executed and before the subrecipient completed the environmental review determination.

Documentation was provided to the Auditor indicating that the contract was executed on 6/15/09, and the check was issued on 6/30/09. It did include a reimbursement of costs incurred prior to the execution of the contract, which is allowed under NSP in accordance with [FAQ ID: 774](#).

With regard to the timely completion of the environmental review, this issue was identified by DOH as part of its monitoring of the grantee community. DOH worked with the community to develop corrective action which resulted in the subsequent completion of the environmental review, which confirmed no environmental impact. Procedures were put in place to ensure that all future environmental reviews were completed in a timely manner. It was determined that as there was no negative impact on the property or the community, that the costs were acceptable as part of the corrective action.

Comment 4

-- \$4,000 – Audit purports that funds were disbursed for costs that were also paid by another Federal program. Confirmation of condition is underway, and reimbursement to the other federal program (Lead Hazard Mitigation) from non-federal sources will be made, if appropriate.

Comment 5

-- \$4,193 – Audit purports that funds were paid for duplicate items or services paid with NSP funds and costs paid that should have been part of the developer fee.

- \$2,053 paid for Clerk of the Works at 27-29 Columbus, Bridgeport: this is an eligible cost of the project, and should not be paid out of developer fee, as purported by audit.
- \$1,640 in duplicate payments at 12 Armstrong, Bridgeport; confirmation is underway, and reimbursement to other federal program from non-federal sources will be made, if appropriate.
- \$500 in overpayment in accordance with final Cost Certification. Reimbursement to NSP pending.

Comment 6

-- \$54,144 – These costs were attributable to a failed project; developer went bankrupt. Costs incurred were both eligible and verified as paid. This is part of the cost of doing business with difficult properties in a difficult neighborhood and costs should not be deemed “ineligible”. However, project remains open, and community is negotiating with a potential developer to complete these parcels using alternative sources.

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Evaluation**

Auditee Comments

Comment 7

-- \$29,106 – Audit purports that costs were unreasonable; Department determined that costs were reasonable and in accordance with allowable industry standards and Departmental policy (developer fee =15% or less). Property acquired required little rehab; it was deemed unreasonable to allocate a smaller developer fee based on work performed. Department believes this is supported by FAQ ID: 566.

Comment 8

-- \$123,108 – Audit purports that ineligible administrative fees were paid to two developers. Department's position is: 1) at the time this occurred (8/2009), guidance had not yet been issued by HUD (guidance issued 6/1/12) and it was not clear from the NSP regulations that this was not appropriate; 2) the developers were carrying out both administrative duties as well as developer duties; 3) contract documents reflected eligibility for both fees; 4) Once guidance became clear, practice was revised.

Comment 9

Funds Disbursed for Inadequately Supported Costs – Disagree (1D)

-- \$1.8MM – Audit purported that subrecipient staff did not always document that costs of more than \$1.8 million were supported for 14 properties. Department does not agree with the interpretation of 24 CFR Part 85.36 as it applies to this activity. Competitive proposals were used and selected, as appropriate, and evaluated to determine both reasonable cost as well as necessary scope. All properties were required, as part of all programs, to be brought up to local code, predetermining scope prior to bid. All properties received a final inspection as part of the issuance of a certificate of occupancy by local building officials, as well as periodic inspections throughout the rehabilitation period. The State of Connecticut believes strongly in the principles of LEAN, and requiring steps that bring no added value to the process are actively eliminated. The State and Subgrantee communities relied heavily on the development community directly involved in these neighborhoods to ensure that these properties had the best opportunity to be brought up to code and eliminate the blight caused by their original condition. Local rehabilitation systems, as supported through the local building inspectors as well as community development staff ensured that costs were necessary and reasonable. In addition, no payments were processed without explicit and detailed review of invoices by contractors as to eligibility and reasonableness of cost.

Comment 10

-- \$45,576 – Audit purported that one subrecipient included a fixed 15 percent project delivery cost totaling \$45,576 for two properties with no documentation showing the basis for the percentage. As disclosed by community, this is the standard fee that is charged on all of their housing redevelopment activities, regardless of source. The Regulations at 2 CFR Part 225, appendix A (C)(1)(e) requires that costs be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the government unit.

Comment 11

Achievement of a National Objective Was Not Ensured – Disagree (1G)

Audit purports that State officials did not ensure that their subrecipients supported that six activities met a national objective. The projects identified are all associated with failed attempts at redeveloping difficult properties in difficult neighborhoods where the original developer either went out of business in mid-redevelopment, or experienced other issues which lead to the current condition (e.g. environmental issues). In addition, the Department is actively working with the grantee communities to ensure that the properties are completed within a reasonable

**Ref to OIG
Evaluation**

Auditee Comments

Comment 12

timeframe with a new development entity (or entities), and will be completed in accordance with meeting a National Objective. It is the Department's position that to characterize these open projects as failing to ensure that a National Objective was met is inappropriate at this time.

Further, the audit purported that there was one property for which beneficiary information was not adequate to ensure that the home buyer was income eligible. The Department does not agree with this analysis; there was more than sufficient information obtained (tax returns for 2008 and 2009, and supporting cancelled checks for 2010) to ensure that the beneficiary family was income eligible (2009 family income was reported as \$43,200 at the time of purchase, and the applicable income limit was \$69,100). Although we acknowledge that some additional information provided by the beneficiary raises questions as to the source of some revenue (not necessarily "income"), the Grantee community deemed it unnecessary to pursue this issue further, and the Department agrees.

Comment 13

Proper Affordability Restrictions Were Not Always Put Into Place – Disagree (1H, 1I)
The Audit purports that State officials did not always ensure that their subrecipients adequately documented that the proper affordability restrictions were in place for five properties reviewed. The Department disagrees with this characterization of the situation. In accordance with its standard procedures under the HOME program, the Department requires an affordability restriction be recorded at the time of acquisition in order to ensure that the property is safeguarded relative to affordability. We have had experience in the past where state funds were used to acquire, and the developer attempted to quickly "flip" the property without a restriction on it. Our current standard practice is to modify and extend the affordability period AFTER the project is closed out and turned over to the homebuyer. This ensures that the property is safeguarded immediately upon acquisition, as well as ensure that the full term of affordability is met, in accordance with the HOME program requirements.

Comment 14

Program Income Was Not Properly Administered – Disagree (1M, 1N)
The Audit purports that the developer for one subrecipient, which developed three properties, had not remitted approximately \$212,496 in program income upon the sale of the properties. At the current time, \$204,323.25 of these funds have been recovered as program income, and the grantee community and the developer are currently at odds over the remainder. The Department will continue to work with the grantee community to address the remaining balance, either as documented legitimate expenditures, or through recovery of program income.

Comment 15

The Action Plan Was Amended Without HUD and Public Notification – Disagree (1O)
The Audit purports that Subrecipient officials expanded the target areas to be assisted with NSP funds without notifying the State as required. As a result, State officials did not publicly amend the action plan or notify HUD. The Department disagrees with this finding, as supported by NSP FAQ ID: 861, which states that NSP1 and 3 grantees can undertake activities on a limited number of units that are outside of the established target areas if the units are located in adjacent, eligible census tracts according to the grantee's approved Annual Action Plan. The activities must be reasonably related to addressing the overall foreclosure and abandonment problem in the community. No new Action Plan amendment would be required if the proposed activity was described in the original plan. The property identified by the Audit is in an adjacent, eligible census tract, and therefore does not require an amended Action Plan.

**Ref to OIG
Evaluation**

Auditee Comments

Comment 16

State Officials Did Not Provide Adequate Oversight and Monitoring of Their Subrecipients – Disagree (1P)

The Audit purports that the State delegated the administration of its NSP allocation to 10 subrecipients but remained accountable for the administration and monitoring of those funds, and acknowledges that State officials performed limited monitoring and oversight of their subrecipients. In accordance with NSP FAQ ID: 951, NSP has no requirement regarding the frequency of monitoring. However, the Department supports and complies with the monitoring recommendations identified in the HUD Webinar “Monitoring of Subgrantees” initially released on May 5, 2011. This webinar recommends that the “ideal” approach to monitoring is to “Avoid a *gotcha mentality* that focuses on a) Catching subgrantees making mistakes, and b) Nailing them with blame.” The Department used both onsite and desk monitoring to attempt to work with our grantee communities to assist them in implementing a constantly changing and complex new federal program which used rules pulled from two very disparate federal programs (HOME and CDBG). The Department has worked and continues to work with our grantee communities to identify and address both deficiencies and less effective practices to make improvements to these local programs.

Comment 17

Significant Deficiencies

Based on the foregoing, the State does not agree that the four items are significant deficiencies. We acknowledge that improvements to State systems and processes can be made, and are committed to continued improvement along these lines.

- The State did not have adequate controls over efficiency and effectiveness of program operations when officials did not adequately monitor and oversee the State’s subrecipients to ensure that they followed NSP requirements and had implemented adequate policies and procedures (finding). **See response to 1P above.**
- The State did not have adequate controls over the reliability of financial data when officials did not establish adequate financial controls to ensure that the requisitions for funds were adequately supported and costs were eligible, necessary, and reasonable (finding). **See response to 1D above.**
- The State did not have adequate controls over compliance with laws and regulations when officials did not always comply with HUD regulations to ensure that activities met a national objective, the purchase price discount was properly supported, the environmental review was performed in a timely manner, and the public and HUD were notified when target areas were revised in the action plan (finding). **See response to 1A thru 1G above.**
- The State did not have an adequate system to ensure that resources were properly safeguarded when officials did not always ensure that the proper affordability restrictions were put into place and program income was accounted for and returned as required (finding). **See response to 1H and 1I above.**

OIG Evaluation of Auditee Comments

- Comment 1 State officials provided the basis for their agreement and disagreement with the report's recommendations below; we provided our response below where they provided their basis.
- Comment 2 We adjusted the report to remove the duplicate recommendation in 1L.
- Comment 3 We disagree with the State's interpretation of NSP frequently asked question 774 that acquisition and rehabilitation costs incurred before the execution of the contract were allowable. Further, we maintain that the developer was not eligible for acquisition assistance under eligible use B, purchase and rehabilitation, since the property did not meet the definition of a foreclosed-upon or abandoned property at the time the funds were awarded to the developer. (The property would be eligible for rehabilitation assistance under eligible use E, redevelopment, as it was a vacant property.) Further, while we acknowledge that the State identified the untimely environmental review during its monitoring and may have ensured that an environmental review was conducted, completion of an environmental review before commitment of funds is a statutory requirement. Regulations at 24 CFR 570.5 permit the Secretary to waive requirements only under the CDBG regulations that are not required by law. Therefore, we maintain that \$604,331 paid for acquisition and rehabilitation costs incurred before completion of an environmental review was an ineligible expense, and we have revised the wording to clarify our position.
- Comment 4 State officials are confirming any duplicate payments and agreed to reimburse any such payments. HUD will need to confirm whether there were duplicate payments and ensure repayment of such during the audit resolution process.
- Comment 5 State officials maintain that \$2,053 paid for a "Clerk of the Works" fee is an eligible project cost that should not be paid from the developer fee. We maintain that the fee represents a project management cost, which should be covered by the developer fee. State officials are determining whether the \$1,640 was a duplicate payment and if so, will make reimbursement as they will for the \$500, which they agree was an overpayment. HUD will need to ensure that any ineligible costs are reimbursed during the audit resolution process.
- Comment 6 State officials maintain that the developer went bankrupt and while the projects were not completed, the costs incurred were an eligible cost of doing business. However, the developer defaulted on its contract with the subrecipient, as it did not meet contract timeframes and the subrecipient renegotiated with the developer to complete three rather than seven of the modular homes. For the four modular homes that it did not complete, the funds should have been repaid by the developer at that point. If the developer was bankrupt at that time, as the State indicated in its response, the subrecipient should not have continued to work with the developer on the other three modular homes. The developer was paid a total

of \$836,082 in NSP funds under the contract and did not complete any of the projects.

- Comment 7 State officials maintain that the costs were reasonable based on industry standards and the State’s policy that allowed a 15 percent or less developer fee. We maintain that the developer purchased the property and spent \$7,920 in rehabilitation costs yet received a \$36,383 developer fee and was also reimbursed for closing costs and other fees it incurred. The City gave the developer a 15 percent developer fee rather than a 3 percent acquisition fee, which was typically given to other developers. According to NSP frequently asked question 566, “Reasonable developer fees are defined in relation to the functions and responsibilities the developer undertakes. There are various factors that can help NSP grantees determine what is reasonable, including the risk of the project and what is customary for similar types of projects in their community.” Given the lack of complexity and limited risk taken by the developer in this case, the fee was not reasonable. Although a 15 percent developer fee was typical for the larger, more complex projects reviewed, in this case, the developer fee was not appropriate for the amount of work and risk taken by the developer.
- Comment 8 State officials stated that HUD guidance had not been issued when they included services for both administrative work and development in the same contract and that the developer completed both administrative tasks and development. Therefore, we revised the questioned costs from \$123,108 in ineligible costs to unsupported costs to give State officials the opportunity to support that the developer earned both a developer fee and administrative fees in accordance with its contract.
- Comment 9 State officials stated that competitive proposals were used as necessary, costs were determined to be reasonable and necessary, and that all projects received periodic and final inspections as evidenced by the occupancy certificate issued by the local building departments. State officials further stated that payments were not made without a detailed review of invoices to ensure the eligibility and reasonableness of costs. We maintain that the State’s subrecipients did not always use competitive proposals as the State maintains, and its developers did not always obtain competitive bids for rehabilitation work, nor were they required to according to NSP Policy Alert, “Guidance on NSP-Eligible Acquisition & Rehabilitation Activities,” dated December 11, 2009. However, the subrecipients were required to review the developers’ proposals for each project for cost reasonableness in accordance with 24 CFR 85.36. The subrecipients entered into agreements with developers based on budgets submitted by the developers without documenting an independent cost estimate or a review of cost reasonableness for the specific properties. Further, subrecipients did not always document that initial, interim, and final inspections were conducted to verify that the work was necessary and performed in accordance with the scope of work. Some subrecipient staff members told us that they did not perform inspections, cost estimates, or cost reasonableness reviews and relied on the developers. In

addition, subrecipients did not always support all costs with adequate invoices. Without an initial inspection performed by the subrecipients to determine necessary costs, an independent cost estimate, and a review for cost reasonableness, it is unclear how State officials could conclude that all work was necessary, reasonable, and adequately supported. State officials will need to provide additional documentation to HUD during the audit resolution process to support their position.

Comment 10 State officials' position is that the 15 percent developer fee is the standard fee charged on all the developer's redevelopment activities and referred to regulations at 2 CFR Part 225 appendix A (C)(1)(c), which requires that costs be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit. We disagree because they charge this fixed fee on other developments that they were allowed to do so without supporting the costs. Regulations at 2 CFR Part 225 appendix A (C)(1)(j) requires that costs also be adequately documented. Accordingly, charging a fixed percentage of cost to each project without adequate documentation to support the costs, regardless of whether it typically charged a 15 percent fee on all of its housing development activities, would not be appropriate.

Comment 11 State officials' position is that the questioned activities were failed attempts at developing difficult properties in difficult neighborhoods where the original developer went out of business in mid-development or experienced other issues that led to the current conditions. State officials stated that they are working to complete these projects. We maintain that while regulations do not state a specific timeframe for when an activity must meet a national objective, the projects identified not only exceeded the timeframes identified in the written agreements between the developers and the subrecipients and the agreements between the subrecipient and State, but also extended what would be considered a reasonable timeframe. For instance, as noted in the report, while a subrecipient for four of the incomplete projects told us in December 2014 that it was working with a nonprofit developer to take over three of the properties, as of April 2016, there was no agreement in place with the nonprofit developer. Further, our inspection in March 2016 of one of the properties that had been partially renovated disclosed that the walls and ceilings appeared to be covered in mold and another property appeared to have a squatter living in the property. These properties should have been completed within a reasonable timeframe, or the activities should have been canceled and the funds deobligated and reprogrammed.

Comment 12 While State officials acknowledged that there are questions as to the source of beneficiary revenues, they maintained that there was sufficient information to ensure that the home buyer was income eligible. We maintain that although the tax return showed that the income reported met the income limits and the subrecipient obtained current income information to make a determination, the subrecipient should have followed up on discrepancies between the tax returns

and all of the deposits shown on the bank statements. Therefore, the available information was not adequate to conclude that the beneficiary was income eligible and the activity met a national objective.

- Comment 13 We agree that that the State recorded the restriction at the time of acquisition; however, the restrictions were not updated as the State explained was its process. The restrictions in place for two of the properties did not cover the entire affordability period and did not identify the income limit requirements for the rental units for three of the properties as required. The State did not revise the affordability restriction at the time of sale to the home buyers, which was more than 2½ years after the affordability restrictions were put into place. Therefore, HUD lacked assurance that the State would update these restrictions at a later date.
- Comment 14 State officials provided documentation at the exit conference supporting that \$204,323 had been recovered as program income and stated that they would continue to work with the subrecipient to address the remaining balance. These actions are responsive to our recommendation, and HUD will need to verify during the audit resolution process that amounts recovered have been properly reported and reallocated to eligible NSP activities.
- Comment 15 Additional guidance from HUD allowed grantees to go outside of the target areas for a limited number of properties if they were in an adjacent neighborhood, eligible census tract, and the activity was included in the action plan. Accordingly, we adjusted the report, recommendations, and internal controls section to remove any deficiency related to obtaining public comment and HUD approval for action plan amendments.
- Comment 16 State officials' position is that NSP has no requirement regarding the frequency of monitoring and that they performed onsite and desk monitoring of their subrecipients and continue to work with them to identify and address deficiencies. We maintain that although HUD does not specify how much monitoring should be performed, State officials should consider risk when determining how often and to what extent it should monitor its subrecipients. The State should have more closely monitored the subrecipients that had higher risk, such as those not completing projects within the required timeframes. One of the subrecipients did not maintain files for some of its projects and did not always provide timely and adequate source documentation as requested by us. Further, the State and subrecipient could not provide the State's monitoring letter to the subrecipient to indicate what was found during its monitoring. Our review of this subrecipient showed significant deficiencies, including incomplete projects.
- Comment 17 State officials disagreed with the characterization of the control deficiencies as significant, but nevertheless agreed that controls could be strengthened. We maintain that the deficiencies noted were significant given the conditions identified. No changes were made to this section except to remove the condition related to revising the action plan for the property that was outside the target area.

Appendix C

Appendix C

Schedule of Deficiencies and Questioned Costs by Property (Numbers Are Rounded)

	Address	National objective not supported	Property not purchased at a discount	Proper affordability restrictions not in place	Necessity and reasonableness of costs not supported	Program income not properly administered	Unsupported costs	Ineligible costs	Unreasonable costs	Funds to be put to better use	Total questioned costs
Sample selection results (24 properties)											
1	354 Lynne Place, Bridgeport				X				\$29,106		\$29,106
2	12 Armstrong Place, Bridgeport			X	X	X	\$270,852	\$1,640		\$52,047	\$324,539
3	85 White Street, Bridgeport ¹⁴	X			X		\$260,646	\$18,048			\$278,694
4	76 White Street, Bridgeport	X			X		\$260,646	\$18,048			\$278,694
5	727 Arctic Street, Bridgeport	X			X		\$260,646	\$18,048			\$278,694
6	27-29 Columbia Court, Bridgeport				X		\$196,093	\$2,053			\$198,146

¹⁴ We prorated the ineligible costs for 76 White Street, 85 White Street, and 727 Arctic Street as invoices submitted were for all seven properties and it was not clear which specific properties the costs were charged against.

	Address	National objective not supported	Property not purchased at a discount	Proper affordability restrictions not in place	Necessity and reasonableness of costs not supported	Program income not properly administered	Unsupported costs	Ineligible costs	Unreasonable costs	Funds to be put to better use	Total questioned costs
7	337 Knowlton Street, Bridgeport				X		\$155,620				\$155,620
8	405 Knowlton Street, Bridgeport										\$0
9	645 Knowlton Street, Bridgeport										\$0
10	15 Scuppo Road, Unit 1501, Danbury										\$0
11	97-99 Park Avenue, Unit 43B, Danbury		X					\$1,660			\$1,660
12	68 Booth Street, New Britain ¹⁵				X			\$604,331			\$604,331
13	44 Greenwood Street, New Britain	X			X		\$125,638				\$125,638
14	144 Winthrop Street, New Britain				X		\$18,411				\$18,411
15	212 Dover Street, New Haven				X			\$500			\$500

¹⁵ The City of New Britain also did not perform the environmental review before committing and spending funds. Therefore, the funds were ineligible.

	Address	National objective not supported	Property not purchased at a discount	Proper affordability restrictions not in place	Necessity and reasonableness of costs not supported	Program income not properly administered	Unsupported costs	Ineligible costs	Unreasonable costs	Funds to be put to better use	Total questioned costs
16	76 Perkins Street, New Haven										\$0
17	69 West Street, New London			X	X		\$26,000				\$26,000
18	94 Williams Street, New London			X	X		\$71,154				\$71,154
19	13 Brainard Street, New London				X		\$25,454				\$25,454
20	154 Prospect Street, Norwich				X		\$24,600				\$24,600
21	39 Oakridge Street, Norwich				X		\$76,396	\$4,000			\$80,396
22	500 Boswell Avenue, Norwich				X		\$133,675				\$133,675
23	92 West North Street, Stamford			X							\$0
24	54 Liberty Street #4, Stamford			X							\$0
Total results of 24 properties		4	1	5	17	1	\$1,905,832	\$668,328	\$29,106	\$52,047	\$2,655,313
Limited review results (5 properties)											
1	354 & 360 Main Street, Bridgeport	X					\$104,882				\$104,882

	Address	National objective not supported	Property not purchased at a discount	Proper affordability restrictions not in place	Necessity and reasonableness of costs not supported	Program income not properly administered	Unsupported costs	Ineligible costs	Unreasonable costs	Funds to be put to better use	Total questioned costs
2	123 Read Street, Bridgeport					X				\$105,000	\$105,000
3	2 Williams Place, Bridgeport					X				\$55,449	\$55,449
4	34 Benedict Avenue, Unit B, Danbury		X					\$2,450			\$2,450
5	384 Blatchley Avenue, New Haven	X					\$50,828				\$50,828
Total results of 5 properties		2	1	0	0	2	\$155,710	\$2,450	\$0	\$160,449	\$318,609
Grand total of sample and limited review results (29 properties)		6	2	5	17	3	\$2,061,542	\$670,778	\$29,106	\$212,496	\$2,973,922
Administrative costs											
Not applicable ¹⁶							\$123,108		\$0	\$0	\$123,108
Total administrative costs							\$123,108		\$0	\$0	\$123,108
Grand total of questioned costs for 29 properties and administrative costs							\$2,184,650	\$670,778	\$29,106	\$212,496	\$3,097,030

¹⁶ City of Bridgeport