



Mayor Jim Newberry

## LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT

Division of Internal Audit

### **INTERNAL AUDIT REPORT**

DATE: January 24, 2007

TO: Jim Newberry, Mayor

CC: Charlie Boland, CAO  
Paula King, Director of Community Development  
Kevin Smith, President of Community Ventures Corporation  
Internal Audit Board Members  
Urban County Council members

FROM: Bruce Sahli, Director of Internal Audit

RE: Community Ventures Corporation HOME Program Reporting Audit

#### **Background**

The Division of Community Development (CD) is awarded a HOME Investment Partnerships Program grant from the U.S. Department of Housing and Urban Development (HUD) to assist low-income families in achieving home ownership. CD contracts with various non-profit organizations (considered subrecipients) to administer the program. Community Ventures Corporation (CVC) is one such non-profit organization, which was allocated \$200,000 in HOME funds for Fiscal Year 2007. One of the services CVC provides is a Lease Purchase Program whereby CVC acquires and rehabilitates (or newly constructs) houses and then leases them to income-eligible clients for a period of time, typically two years. During this lease time, individuals or families are assisted to become financially stable and better prepared for home ownership. Under this program, individuals or families that demonstrate readiness for home ownership subsequently assume ownership of the home from CVC with first mortgage financing from a bank partner or directly from CVC.

The Division of Community Development has the responsibility to monitor fund recipients activity to ensure compliance with HUD program guidelines. CD receives periodic reports from CVC to assist them in their oversight function. CVC requests HOME funds from LFUCG which are withdrawn from LFUCG accounts via Automated Clearing House transactions (referred to as draw downs).

The Division of Internal Audit received a request from former CAO Milton Dohoney and Division of Community Development Director Paula King for the examination of financial records at CVC. The

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request sought reasonable assurance of the proper reporting of CVC's financial position as it relates to their receipt of HUD HOME funds, with particular emphasis placed on the recapturing of HUD funds when a home buyer subsequently sells the property purchased through the CVC program prior to the end of the affordability period established by HUD guidelines. Recaptured funds are HOME funds which are recouped by the participating jurisdiction (i.e. LFUCG) when HOME assisted homeownership housing does not continue to be the principal residence of the assisted homebuyer for the full affordability period required by CFR 92.254 (a) (4). This audit is the result of that request.

### **Scope and Objectives**

The general control objectives for the audit were to determine that:

- CVC complied with HUD guidelines when reporting HOME Program income to LFUCG
- CVC accurately reported recaptured funds to LFUCG on a timely basis
- CD HOME Program activity was properly monitored by LFUCG personnel for compliance with the Agreement between LFUCG and CVC

The period of review was program income reported by CVC for the period January 1, 2004 through December 31, 2005, and HUD Local Home Open Activities reported to LFUCG as of September 30, 2005. The decision was made to focus the audit on recaptured funds as this appeared to be the area of primary contention between CD and CVC. As an independent public accountant had performed the Circular A-133 audits of CVC for the periods under review and had issued a clean opinion on the accuracy of the financial statements, it was decided that there existed no probable cause for expanding our audit into the area of financial statement attestation.

### **Statement of Auditing Standards**

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

### **Audit Opinion**

In our opinion, the controls and procedures provided reasonable assurance that the general control objectives were being met. Opportunities to enhance controls are included in the Summary of Audit Findings.

## **SUMMARY OF AUDIT FINDINGS**

**CVC Recaptured HOME Funds not Returned to LFUCG**

The LFUCG First Time Homebuyer Assistance and Resale Restriction Guidelines attached to the agreement between Community Ventures Corporation and Community Development states that “any HOME funds recaptured by the grantor agency under the provisions of these guidelines shall be returned to the Lexington-Fayette Urban County Government within ten days of receipt, unless otherwise noted in a written agreement.” Our review of 18 Lease to Purchase cases indicated that, in nine of the ten cases where HOME funds were recaptured by CVC, the recaptured funds were not returned to LFUCG. Instead, the recaptured funds were deposited into CVC’s HOME account to be recycled as program income. The total amount of unreported recaptures for the nine cases noted is \$135,391.29. The remaining eight cases did not exhibit those circumstances that would have required the recapturing of funds.

We recommend that CVC return those funds identified during the audit to LFUCG to be placed in the draw down account for future HOME Program use. CVC should also adhere to the agreement with LFUCG and return future recaptured funds within ten days of receipt.

**Community Ventures Corporation Management Response:**

This references your draft report provided to us in our meeting of December 7, 2006 which summarizes findings from an audit LFUCG conducted relative to our reporting of program income and recaptured funds from our HOME funded projects. This provides our response to your finding.

First of all, I would like to say we appreciate the professionalism you and Teressa Gipson exhibited while conducting your scope of work. Your thorough work and cordiality is greatly appreciated.

Based upon the evidence you present in your draft report, as well as our conversation about this process, Community Ventures Corporation agrees that this agency is required to return recaptured funds generated from HOME funded projects to the LFUCG. This is clear in the written contract between LFUCG and CVC. However, please note that CVC has reported and used recaptured funds in the same manner for the past 10 years, with LFUCG’s knowledge and approval. Our retention and use of recaptured funds to provide assistance to low-income homebuyers has never been questioned until this time. If LFUCG’s Division of Community Development will provide us with guidelines in writing, relevant to the reporting and return of recaptured HOME funds, CVC is more than willing to oblige. (AUDITOR’S NOTE: Division of Community Development management states that CVC’s recaptured funds were being returned to LFUCG prior to the February 5, 2004 amended agreement which allowed CVC to retain program income. Under that amended agreement, the distinction between program income and recaptured funds apparently became confused).

Regarding the reporting of recaptured HOME funds, CVC is willing to provide any type of report LFUCG requests relevant to our HOME-funded project. In the past, CVC has asked on numerous occasions for the Community Development Division to provide us with standard reporting instructions, as well as applicable forms, to ensure we report specific information LFUCG requires to properly monitor our HOME projects. (AUDITORS NOTE: This issue is addressed in the finding Improved Communication Between CVC and CD Recommended). CVC has contracts with several

federal and state funders, all of whom require standard reports. LFUCG is the only partner who does not have a standard reporting process.

### **CVC not Monitored Annually as Required**

The federal Office of Management and Budget (OMB) compliance supplement report indicates that subrecipient monitoring activities normally occur throughout the year and may take various forms such as reviewing financial and performance reports, performing site visits to review financial and programmatic records, or regular contacts with the subrecipient. In the Division of Community Development's 2005 Consolidated Plan reported to HUD (which is still relevant for monitoring purposes), CD stated that they would use the monitoring review and financial audit methods to provide oversight of CVC's HOME Program. Specifically, CD's consolidated Plan states, "The monitoring review involves the use of a checklist by a Grants Manager on an annual scheduled monitoring visit to agencies who have been awarded funds from these federal programs." Additionally, the Plan states that Community Development's monitoring visits will determine if the project generates program income and if program income is properly documented and reported to the LFUCG.

According to documentation obtained and inquiries conducted during the audit, CVC has not received an annual scheduled monitoring visit since fiscal year 2004. It was also noted that during the 2004 monitoring visit that client files were not sampled to verify that program income was properly documented and if the recapture of funds was needed.

We recommend that Community Development monitor CVC on an annual basis regarding reporting and program income to ensure that all program income is calculated correctly and it is reported timely. Community Development should track all program income and recaptured funds to ensure that program income is expended prior to requesting additional federal draw downs. CVC should also be monitored to determine that all recaptures have been reported.

### **Division of Community Development Management Response:**

Community Development monitored the subrecipient on April 22, 2004. A follow-up monitoring visit was made on May 13, 2004. The monitoring report was issued to the subrecipient on June 14, 2004. The subrecipient did not correct the findings noted until April 15, 2005 due to the legal assistance required to correct the findings. Program Income was not reviewed during this visit because program income was being returned to the government at the end of a program year. Program income was not retained by the subrecipient until the contract dated February 5, 2004. During this time period, the government continued to review and approve all client files for the program and was in constant contact with the subrecipient via email, telephone conversations, and meetings. Although an official on-site monitoring review was not completed as noted in the Consolidated Plan, reviews were being completed as we approved a file or came across an issued that needed to be resolved. The correspondence file supports the Division's efforts to address program issues as they were identified. Due to limited staff, the Division has developed as stated in the Consolidated Plan, a risk-analysis to reduce the number of required on-site monitoring visits. The on-

site monitoring review for 2006 is still in progress. (Auditor's Note: The 2006 monitoring review began in December 2006, after the completion of audit fieldwork.)

In regards to recaptured income, the Division maintains a spreadsheet with the original lease date and reviews periodically to determine if a unit has exceeded or is approaching the date whereby the funds must be recaptured. In no instance has funds been requested from the federal government that do not account for program income received. Federal HOME funds are normally drawn down at least 30 days after the monthly accounting books are closed, which generally always allows one month of expenses still to be drawn down. The Division maintains an on-going spreadsheet of program income on hand and if applicable, recaptures possibly due for the subrecipient and adjusts the federal funds drawn based on these numbers.

### **Improved Communication Between CVC and CD Recommended**

It appears that disconnected communication between CVC and CD played a significant role in the circumstances that eventually led to the request for the audit as described in the Background section of this report. As an indication of this disconnection, during the audit the President of CVC stated that he would be willing to provide whatever information CD needed to address those issues that had arisen regarding the reporting of HOME program income, recaptured funds, etc, while CD personnel stated they sometimes had to make multiple attempts to obtain information they viewed as basic to their oversight function.

We requested that CD develop a specific list of documentation they deemed as fundamentally important for their oversight of HOME Program cases in order to bridge the communication gap and enhance cooperation between CVC and CD. The specific list as developed by CD is provided on an attachment to this report.

HUD has assigned responsibility to LFUCG for primary oversight of the administration of federal HOME Program funds in Fayette County. Recognizing the importance of fulfilling this fiduciary duty, it is therefore recommended CVC provide all these requested documents to CD on a timely basis for each HOME Program case in order to enhance communication, cooperation, and oversight in the administration of the HOME Program.

### **Community Ventures Corporation Management Response:**

This references your new audit finding and recommendation for the Community Ventures Corporation (CVC) draft audit report (per your email of January 5, 2007). This provides our response to this new finding.

First of all, thank you for your assistance in improving communications between CVC and LFUCG's Community Development (CD) Division. We are in complete agreement that communication between the two parties needs significant improvement.

We continue to have concerns about CD's allegation that CVC is often late in submitting documents requested from CD for its HOME files. Please note that in 2005-2006, there were no delays in

transfer of information from CVC and LFUCG for HOME customers; each HOME loan submitted to LFUCG was closed by LFUCG without requests for additional information from CVC. (AUDITOR'S NOTE: This comment is disputed by Division of Community Development management). The checklist attached to your latest finding is the checklist CVC has always used, and each document is forwarded to CD as requested. If required information was not received from CVC, then LFUCG would not have closed HOME loans as happened.

The only delay in information transfer, from CVC to CD, involved requests from CD for CVC to forward documents relevant to files which were approved and closed 4-5 years ago. For whatever reason, CD declared some of its older HOME files incomplete and, therefore, placed the burden on CVC to gather missing documents. This required CVC staff to "dig" through archived files to retrieve CD's requested information. CVC did inform CD staff, in advance, that retrieval of requested documents would take some time. This action has placed a costly burden on CVC (both in terms of time and money), and has actually caused delay in moving newer homebuyers to closing, as staff time has been spent on assisting CD to "clean up" their own files. (AUDITOR'S NOTE: Division of Community Development management stated there is no statute of limitations on the review of HOME Program files and that the files referenced in this CVC response did not contain all the relevant information).

**COMMUNITY VENTURES CORPORATION HOME PROGRAM REPORTING AUDIT**  
**HOME PROGRAM DOCUMENT CHECKLIST**

CVC Loan Packet Letter  
CVC Loan Requirements/Payment Request Form  
Affordability Analysis  
Completed & signed CVC Intake Application  
Drivers License and Social Security Card  
Counseling Certificate  
CVC Subsidy Calculation Form  
Verification of Borrower(s) Income w/ calculations  
Verification of Dependent Status for household members 18 years of age  
Credit Report  
Completed & Signed Prime Lender Loan Application  
Lender's Good Faith Estimate  
Lender's Mortgage Commitment letter including monthly payment or KHC Underwriting Decision  
Verification of Deposit and/or Gift Letter  
Borrower's Contribution  
Offer to Purchase Contract (signed)  
Appraisal  
City Environmental Review Checklist  
Inspection Report  
First Time Homebuyers Affidavit (signed)  
URA Waiver Statement (Pre-Contract Agreement)  
CVC Terms of Agreement (signed)

AUDITOR'S NOTE: This list as provided by the Director of Community Development indicates the standard documentation deemed necessary to ensure LFUCG's proper oversight of individual HOME Program cases as administered by Community Ventures Corporation. This list is provided to enhance communication between the Division of Community Development and Community Ventures Corporation. The Division of Community Development reserves the right to request additional documentation if necessary to ensure an appropriate level of oversight.