



Issue Date	October 29, 2002
Audit Case Number	2003-CH-1002

TO: Robert S. Berlan, Director of Community Planning and Development, Milwaukee Field Office

FROM:   
Heath Wolfe, Regional Inspector General for Audit, Region V

SUBJECT: New Covenant Housing Corporation, Inc.  
Community Development Block Grant And HOME Programs  
Milwaukee, Wisconsin

### INTRODUCTION

We completed an audit of New Covenant Housing Corporation's Parkwest Townhouses Phase II project. The audit resulted from a citizen complaint to our Office. The objectives of our audit were to determine whether the complainant's allegations were substantiated and whether HUD's rules and regulations were followed. The complainant's specific allegations were: the general contractor overseeing the project's construction shifted costs from the general operating account to the concrete and carpentry accounts; reimbursement claims for concrete and carpentry costs were inflated; some payroll reimbursement claims were for individuals who did not work on the project; and excessive equipment was purchased for the project.

To accomplish our audit objectives, we reviewed New Covenant Housing Corporation's policies and procedures for the period January 1, 1995 through March 31, 2000. We also reviewed and evaluated the New Covenant's: management controls for safeguarding cash and other monetary assets; Independent Accountant's reports for the period January 1, 1999 through December 31, 2000; and invoices and expenditures charged to the Community Development Block Grant and HOME Programs. In addition, we conducted site visits of Parkwest Townhouses Phase II project.

We reviewed New Covenant Housing Corporation's records, HUD's records, and the City of Milwaukee, Wisconsin's records for Parkwest Townhouses Phase II project. We interviewed New Covenant's Executive Director and consultant who assisted with the project's development, HUD's staff, officials from the State of Wisconsin's Economic Development Authority and the City of Milwaukee, the project's two architects, and the complainant. We performed our on-site audit work

between January 2002 and April 2002. We conducted the audit in accordance with Generally Accepted Government Auditing Standards.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please have them contact Ronald Huritz, Assistant Regional Inspector General for Audit, at (312) 353-6236 extension 2675 or me at (312) 353-7832.

### **SUMMARY**

We found that no Federal funds were directly spent on construction costs for Parkwest Townhouses Phase II project. However, New Covenant Housing Corporation failed to follow Federal requirements and its Community Development Block Grant contract with the City of Milwaukee, Wisconsin by using \$18,700 in Block Grant funds to pay ineligible costs. The ineligible costs consisted of interest expense related to a bank loan owed by Parkwest for construction materials and professional service expenses that were unrelated to the project. The payment of the ineligible costs occurred because New Covenant's Executive Director did not exercise adequate control over cost reports submitted to the City of Milwaukee. As a result, HUD funds were not efficiently and effectively used, and were not available for eligible Block Grant purposes.

### **BACKGROUND**

New Covenant Housing Corporation, Inc. was awarded \$500,000 in Community Development Block Grant funding from the City of Milwaukee, Wisconsin in January 1995. The City awarded the funds for the purpose of developing Parkwest Townhouses Phase II, a 34-unit project located in Milwaukee, Wisconsin. In April 1997, the City increased the Block Grant award to \$650,000 and awarded an additional \$25,000 in HOME funds for the project. Construction of the project was completed in March 2000. New Covenant Housing Corporation drew down funds from January 1995 through March 2000 for the project. The Executive Director of New Covenant is John Moutry. New Covenant's books and records are located at 2331 North 39<sup>th</sup> Street, Milwaukee, Wisconsin.

### **FINDING**

#### **Block Grant Funds Were Used For Ineligible And Unrelated Expenses**

New Covenant Housing Corporation, Inc. violated Federal requirements and its Community Development Block Grant contract with the City of Milwaukee, Wisconsin. Specifically, New Covenant disbursed \$18,700 of Community Development Block Grant funds for ineligible interest expense and costs not related to the construction of Parkwest Townhouses

Phase II project. This situation occurred because New Covenant's Executive Director failed to exercise adequate control over the submission of cost reports to the City. As a result, \$18,700 in HUD funds was not efficiently and effectively used, and was not available for eligible Block Grant purposes.

### **City's Contract Provisions and Federal Requirements**

The contract between the City of Milwaukee, Wisconsin and New Covenant Housing Corporation, effective January 1, 1995, required New Covenant to comply with the cost principles of Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations, regarding the use of Community Development Block Grant funds for Parkwest Townhouses Phase II project. The contract limited New Covenant's use of Block Grant funds only for administrative or soft costs incurred that were reasonable and directly related to the project. Soft costs are defined as non-construction related costs.

Attachment B, Section 23(a)(1), of Office of Management and Budget Circular A-122 prohibits the use of Federal funds to pay for interest on borrowed capital. Attachment A, Sections A(4)(a) and A(4)(b), states cost is allocable to a Federal award if it is incurred specifically for the award. Any cost allocable to a particular award or other cost objective may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

### **Interest Expense Was Improperly Paid**

New Covenant Housing Corporation, Inc. improperly used \$13,576 of Community Development Block Grant funds to pay for interest expense between January 1996 and August 1999. New Covenant's Executive Director said he relied on an outside consultant, engaged to assist with the development of Parkwest Townhouses Phase II project, to determine if expenses were eligible. The consultant said he was not aware that interest expense was an ineligible cost for Community Development Block Grant funding. He also said the City of Milwaukee, Wisconsin treated interest costs as an allowable expense in his prior dealings and the City did not notify him that interest expense was not eligible.

The first table on page 4 of this report shows the Community Development Block Grant funds disbursed by New Covenant for ineligible interest expense.

<b><u>Ineligible Interest Expense</u></b>		
<b>Certification Date</b>	<b>Description Per New Covenant's Records</b>	<b>Amount Disbursed</b>
01/30/96	Construction Interest 12/31/95 per note dated 12/27/95	\$1,216
03/05/96	Loan Interest Jan 30 - Feb 29 1996	962
05/03/96	Interest through 4/30/96	1,903
09/05/96	Interest on Lumber Purchase Loan for May and June 96	1,987
09/05/96	Interest on Lumber Purchase Loan for July and August 96	1,987
11/18/96	Interest on Lumber Purchase Loan for Sept and Oct 96	1,987
01/16/97	Interest on Lumber Purchase Loan for Nov 96	898
01/16/97	Interest on Lumber Purchase Loan for Dec 96 & Jan 97	1,987
08/02/99	96 City Real Estate Tax Bill Interest Due	311
08/02/99	97 City Real Estate Tax Bill Interest Due	219
08/02/99	97 County Real Estate Tax Bill Interest Due	76
08/02/99	98 City Real Estate Tax Bill Interest Due	32
08/02/99	98 County Real Estate Tax Bill Interest Due	11
<b>Total</b>		<b><u>\$13,576</u></b>

**Costs Unrelated To The Project Were Improperly Paid**

New Covenant Housing Corporation, Inc. disbursed \$5,124 in Community Development Block Grant funds between September 1995 and March 1996 for expenses not related to Parkwest Townhouses Phase II project. According to New Covenant's invoices, the unrelated costs were for the preparation of 1993 and 1994 income tax returns and financial statements. The limited partnership that owns Parkwest Townhouses Phase II was not formed until August 30, 1995. Therefore, the costs for the tax returns and financial statements were not directly related to the project. New Covenant's consultant said he viewed Parkwest Townhouses as a continuous project from Phase I through Phase III. He said the costs of the tax returns and financial statements were charged to Phase II because they came due when funding for the project was available.

The following table shows the Community Development Block Grant funds disbursed by New Covenant for expenses unrelated to Parkwest Townhouses Phase II project.

<b><u>Unrelated Expenses</u></b>		
<b>Certification Date</b>	<b>Description Per New Covenant's Records</b>	<b>Amount Disbursed</b>
09/08/95	New Covenant Limited Partnership Tax Return – 94	\$2,640
04/15/97	Reversal of Part of the \$2,640 for Tax Return – 94	(981)
03/05/96	Accounting – Audit of 93 –94 Combined Financial Statements	2,145
03/05/96	Accounting – Audit Statements for 93 & 94	1,320
<b>Total</b>		<b><u>\$5,124</u></b>

As a result of the funds misspent by New Covenant Housing Corporation for ineligible and unrelated expenses, Federal requirements and the Community Development Block Grant contract between New Covenant and the City of Milwaukee were violated. Furthermore, \$18,700 of HUD funds was not effectively used and was not available for eligible Block Grant activities.

### **AUDITEE COMMENTS**

We provided our draft finding to New Covenant Housing Corporation's Executive Director and HUD's staff during the audit. New Covenant's legal counsel provided his comments on the draft finding on July 12, 2002. We held an exit conference with New Covenant's Executive Director on August 9, 2002. We included the comments from New Covenant's legal counsel in Appendix B of this report. New Covenant's Executive Director and the Director of the City of Milwaukee, Wisconsin's Community Block Grant Administration were provided with copies of the audit memorandum report.

[Excerpts paraphrased from the comments provided by New Covenant's legal counsel on our draft finding follow. Appendix B, pages 11 and 12, contains the complete text of the comments for the finding.]

The construction interest expense that was part of the Parkwest Townhouses Phase II project was clearly part of all of New Covenant's contract documents submitted and approved by the City of Milwaukee. At the time the project was undertaken, there was a need to limit the cost of lumber because increasing prices could have made the project infeasible. Therefore, the entire project would have been unable to meet the low-income housing tax credit requirements if the lumber was not purchased by prepayment.

The different phases of New Covenant's Parkwest Townhouses were a series of projects and developed in accordance with a master plan. Therefore, the sequence of payments for amounts associated with all of the projects, including the accounting and auditing fees, was in accordance with the general plan, and was and should be deemed permissible. New Covenant does not believe that any adjustment should be made to any of the aligned items.

### **OIG EVALUATION OF AUDITEE COMMENTS**

We disagree the interest expense was included in the contract documents approved by the City of Milwaukee. The contracts are silent on the matter of interest. Furthermore, the contract between the City of Milwaukee and New Covenant Housing Corporation contained specific language requiring New Covenant to comply with the cost principles of Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations. The Circular expressly prohibits the use of Federal funds for the payment of interest expense.

We also disagree that the different phases of Parkwest Townhouses were regarded as a series of projects for funding purposes. The Community Development Block Grant funds that were the subject of this audit were allocated specifically for New Covenant's Parkwest Townhouses Phase II project. Expenses incurred for accounting and auditing fees for time

periods before Parkwest Townhouses Phase II was initiated are not eligible to be paid with the Block Grant funds. Office of Management and Budget Circular A-122 states that a cost is allocable to a Federal award if it is incurred specifically for the award. Since the accounting and audit expenses were not related to the award of the Block Grant funds for Parkwest Townhouses Phase II, the expenses are unallowable and should be repaid to the City of Milwaukee's Block Grant Program.

**RECOMMENDATION**

We recommend that the Director of Community Planning and Development, Milwaukee Field Office, ensures that New Covenant Housing Corporation, Inc.:

- 1A. Reimburses the City of Milwaukee, Wisconsin's Community Development Block Grant Program \$18,700 from non-Federal funds for the improper payment of interest expense and costs not related to the construction of the Parkwest Townhouses Phase II project. If New Covenant is unable or unwilling to reimburse for the improper payments, then HUD should ensure that the City of Milwaukee reimburses its Block Grant Program from non-Federal funds for the payments.

## MANAGEMENT CONTROLS

In planning and performing our audit, we considered the management controls of New Covenant Housing Corporation, Inc. in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We determined the following management controls were relevant to our audit objectives:

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

We assessed all of the relevant controls identified above.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Based upon our review, we believe the following items are significant weaknesses:

- Program Operations

New Covenant Housing Corporation, Inc. did not administer its Community Development Block Grant funds according to program requirements. Specifically, New Covenant improperly used \$18,700 in Block Grant funds to pay interest expense and costs not related to the construction of Parkwest Townhouses Phase II project (see Finding).

- Compliance with Laws and Regulations

New Covenant Housing Corporation, Inc. did not follow HUD's regulation and Office of Management and Budget Circular A-122 regarding interest expense and the payment of costs not related to the award of Community Development Block Grant funds for the construction of Parkwest Townhouses Phase II project (see Finding).

- Safeguarding Resources

New Covenant Housing Corporation, Inc. improperly paid \$18,700 in Block Grant funds for interest expense and costs not related to the construction of Parkwest Townhouses Phase II project (see Finding).



**FOLLOW-UP ON PRIOR AUDITS**

This is the first audit of New Covenant Housing Corporation, Inc. by HUD's Office of Inspector General. The latest Independent Accountant's Report for New Covenant covered the fiscal year ending December 31, 2000. The Report contained no findings.

Appendix A

**SCHEDULE OF INELIGIBLE COSTS**

<u>Recommendation Number</u>	<u>Ineligible Costs 1/</u>
1A	<u>\$18,700</u>
Total	<u>\$18,700</u>

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.

**AUDITEE COMMENTS**



HUD - OIG  
OFFICE OF AUDIT  
CHICAGO, ILLINOIS  
411 West Wisconsin Avenue  
Milwaukee, Wisconsin 53202-4497  
Tel: 414.277.5000  
Fax: 414.271.3552  
www.quarles.com

Attorneys at Law in:  
Phoenix and Tucson, Arizona  
Naples and Boca Raton, Florida  
Chicago, Illinois (Quarles & Brady LLC)  
Milwaukee and Madison, Wisconsin

2002 JUL 18 AM 10:41

RECEIVED

Writer's Direct Dial: 414.277.5103  
E-Mail: jwd@quarles.com

July 12, 2002

Mr. Ronald F. Huritz  
Assistant Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Ralph H. Metcalfe Federal Building  
77 West Jackson Boulevard, Suite 2646  
Chicago IL 60604-3507

Dear Mr. Huritz:

We are legal counsel for New Covenant Housing Corporation and are in receipt of your letter dated July 3, 2002. We do not believe that any adjustment is required and note the following:

The construction interest which was part of our project was clearly part of all of our contract documents which were submitted and approved by the City. Additionally, we should add that in this circumstance, there is another compelling reason why this interest should be allowed. At the time the project was undertaken, there was a need to limit the cost of the lumber because increasing prices could have made the project not feasible and the entire project would have been unable to meet the tax test if the lumber had not been purchased by prepayment.

Also, as previously indicated, the New Covenant projects were, at all times, deemed to be a series of projects and presented that way and were developed in accordance with a master plan. Therefore, the sequence of payments for amounts associated with all of the projects, including the accounting and audit fees, was in accordance with the general plan, and was and should be deemed permissible. We do not believe that any adjustment should be made to any of the aligned items. We might note

QBMKF5271886.1

Mr. Ronald F. Huritz  
July 12, 2002  
Page 2

that with respect to the interest expense, as we indicated this was clearly part of the contract, and it has been the practice of the City of Milwaukee to acknowledge such appropriate expenditures.

Very truly yours,

**QUARLES & BRADY LLP**

John W. Daniels, Jr.

JWD:gcm

cc: Mr. Johnny L. Moutry, Jr.  
Mr. Michael Heidkamp

QBMKE5271886.1

Appendix C

**DISTRIBUTION OUTSIDE OF HUD**

The Honorable Joseph Lieberman, Chairman, Committee on Government Affairs, 706  
Hart Senate Office Building, United States Senate, Washington, DC 20510

The Honorable Fred Thompson, Ranking Member, Committee on Governmental Affairs,  
340 Dirksen Senate Office Building, United States Senate, Washington, DC 20510

The Honorable Dan Burton, Chairman, Committee on Government Reform, 2185  
Rayburn Building, House of Representatives, Washington, DC 20515

The Honorable Henry A. Waxman, Ranking Member, Committee on Government  
Reform, 2204 Rayburn Building, House of Representatives, Washington, DC 20515

Andy Cochran, Committee on Financial Services, 2129 Rayburn House Office Building,  
United States House of Representatives, Washington DC 20515

Clinton C. Jones, Senior Counsel, Committee on Financial Services, B303 Rayburn Building,  
United States House of Representatives, Washington DC 20515

Sharon Pinkerton, Senior Advisor, Subcommittee on Criminal Justice, Drug Policy &  
Human Resources, B373 Rayburn House Office Building, United States Housing of  
Representatives, Washington, DC 20515

Stanley Czerwinski, Director, Housing and Telecommunications Issues, United States  
General Accounting Office, 441 G Street, NW, Room 2T23, Washington, DC 20548

Steve Redburn, Chief of Housing Branch, Office of Management and Budget, 725 17<sup>th</sup>  
Street, NW, Room 9226, New Executive Office Building, Washington, DC 20503

Linda Halliday (52P), Department of Veterans Affairs, Office of Inspector General, 810  
Vermont Avenue, NW, Washington, DC 20420

William Withrow (52KC), Department of Veterans Affairs, Office of Inspector General  
Audit Operations Division, 1100 Main, Room 1330, Kansas City, Missouri 64105-  
2112

Kay Gibbs, Committee on Financial Services, 2129 Rayburn House Office Building,  
United States House of Representatives, Washington DC 20515

George Reeb, Assistant Inspector General for Health Care Financing Audits

John Moutry, Executive Director of New Covenant Housing Corporation, Inc.

Steven L. Nahan, Director of Community Block Grant Administration, City of Milwaukee,  
200 East Wells, Room 606, Milwaukee, Wisconsin 53202