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| Issue Date | April 24, 2003 |
| Audit Case Number | 2003-CH-1015 |

TO: Jeanette Harris, Director of Community Planning and Development, Detroit
Field Office

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

SUBJECT: Oakwood Neighborhood Association
Community Development Block Grant Program
Kalamazoo, Michigan

INTRODUCTION

We completed an audit of Oakwood Neighborhood Association's Community Development Block Grant Program. The Association is a subrecipient of the City of Kalamazoo's Block Grant Program. The audit was conducted in response to an anonymous complaint to our Hotline. The complainant alleged the Association's former Board Treasurer misused Program funds. The objectives of our audit were to determine whether the complainant's allegation was substantiated, and whether HUD's rules and regulations were properly followed.

To accomplish our audit objectives, we reviewed Oakwood Neighborhood Association's policies and procedures for the period January 1, 1999 to September 30, 2002. We also reviewed and evaluated the Association's: management controls over the Community Development Block Grants with the City of Kalamazoo; Block Grant Applications and Agreements; bank statements and cancelled checks; cash receipts and disbursements journals; general ledger; organization structure; monthly expense reports; By-Laws; position description for its Director; and Board meeting minutes. In addition, we reviewed: 24 CFR Parts 85 and 570; the Housing and Community Development Act of 1974; Office of Management and Budget Circulars A-87, A-122, and A-133; and the Independent Auditor's Single Audit Reports for the City for the period January 1, 1999 through December 31, 2001. We tested all of the \$65,313 in expenses that the Association claimed as reimbursement for its Grants from January 1, 1999 through September 30, 2002.

We reviewed Oakwood Neighborhood Association's records, the City's records for the Association, and HUD's records for the City. We interviewed the Association's current and former Officers and Director, City employees, and staff from HUD's Detroit Field Office of Community Planning and Development. Our audit covered the period January 1, 1999 to September 30, 2002 for the Community Development Block Grants that the Association received. We performed our on-site audit work between November 2002 and February 2003. 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 contact Thomas Towers, Assistant Regional Inspector General for Audit, at (313) 226-6280 extension 8062 or me at (312) 353-7832.

SUMMARY

Oakwood Neighborhood Association did not adequately account for the source and use of Community Development Block Grant Program funds in full compliance with Federal requirements and the City of Kalamazoo's Agreements. Specifically, the Association:

- Did not maintain complete and accurate accounting books and records; and
- Submitted inaccurate monthly expense claims to the City for reimbursement.

BACKGROUND

Title I of the Housing and Community Development Act of 1974, Public Law 93-383, provides local governments with Community Development Block Grant funds to assist in the development of viable urban communities. Not less than 51 percent of the Block Grant assistance must be used for the support of activities benefiting persons of low and moderate income. This includes public services that may be administered and carried out by the grantee or by subrecipients under contract with the grantee. The City of Kalamazoo is an entitlement grantee under HUD's Community Development Block Grant Program. Subrecipients may include public or private nonprofit entities, such as the Oakwood Neighborhood Association. The City executed Block Grant Program Agreements with the Association to provide public services in its neighborhood. Since 1998, the Association was awarded over \$75,000 in Block Grant funds from the City. The following table shows the Grant funds by Program Year.

| <i>Program Year</i> | <i>Block Grant Funds</i> |
|---------------------|--------------------------|
| 1998 | \$18,500 |
| 1999 | 18,600 |
| 2000 | 18,800 |
| 2001 | 19,176 |
| Total | <u>\$75,076</u> |

Effective for Program Year 2002, the City discontinued using Block Grant Program funds for service-related activities. Instead, the City uses monies from its General Fund to pay for the public services provided by the Association.

Oakwood Neighborhood Association is a nonprofit entity and was established over 40 years ago. The Association’s mission is to provide direct and indirect services to assist residents of the Oakwood neighborhood in the City of Kalamazoo, Michigan. The services include crime prevention, housing repairs, agency referrals, neighborhood complaints, and other areas that will improve the neighborhood environment. In February 2003, Gerhard Lovelace resigned as the Association’s President. The Association’s current President is Gary Wager and its Office is located at 3320 Laird Street, Kalamazoo, Michigan.

FINDING

Accountability Over Program Funds Needs Improvement

Oakwood Neighborhood Association did not adequately account for the source and use of Block Grant Program funds in full compliance with Federal requirements and the City’s Agreements. Specifically, the Association: (1) did not maintain complete and accurate accounting records; and (2) submitted monthly expense claims to the City that were inaccurate. The problems occurred because the Association’s former Board Treasurer lacked: (1) an adequate segregation of his assigned duties; (2) a knowledge of accounting principles; and (3) established accounting policies and procedures. Volunteers who were not familiar with Federal requirements and Generally Accepted Accounting Principles prepared the Association’s expense claims and accounting records. Consequently, differences existed between eligible and supported Program costs, and expenses reimbursed by the City. Overall, these differences resulted in the Association having more eligible costs than allowed by the budgeted amounts in the City’s Agreements. In addition, the Association was unable to adequately identify all sources of funds and Program income earned. As a result, the Association's accountability over Program funds was not adequate.

City’s Agreements

The Community Development Block Grant Program Agreements between the City of Kalamazoo and the Association required the Association to follow the Federal cost principles for determining allowable costs. The Agreements also required the Association to comply with the Federal administrative requirements for grants to States and local governments included at 24 CFR Part 85.

Federal Requirements

24 CFR Part 85 requires a subgrantee's financial management system to provide accurate, current, and complete disclosure of the financial results of each Federally assisted program and maintain records that adequately identify the source and application of funds.

Office of Management and Budget Circular A-122, Cost Principles for Nonprofit Organizations, Attachment A, requires that all allowable direct and indirect costs be adequately documented.

Accounting Records Were Not Complete and Adequate

The Association did not maintain complete and accurate accounting records. Specifically, the Association's cash receipts and disbursements journals, chart of accounts, and general ledger were not complete and accurate so that the source and application of all funds and bank records for its Block Grant funded activities could be determined. The following provides examples of weaknesses:

- A monthly accounting journal to account for cash receipts and disbursements was not always prepared. For the months of October 2000, November 2000, and August 2001 to June 2002, no monthly cash journals were provided to the City;
- When a monthly accounting journal was prepared, it did not always identify the source for the cash receipts reflected on the Association's bank statements. For example, a December 21, 1999 deposit for \$1,200.00 was not identified. It was for a television and a video recorder purchased for \$1,170.00 from Sears in December 1999. On May 26, 2000, the Association deposited \$4,520.00 that was not recorded in its monthly accounting journal for May 2000;
- Disbursements did not always agree with the check amounts or the payee. For example, check number 2488 for \$10.62 dated May 22, 1999 was recorded as \$7.27. Check number 1150 for \$162.60 dated January 14, 2000 was recorded as \$163.68 in the Association's accounting journal. Check number 1198 for \$10.00 listed the payee incorrectly as Garage Sale rather than the name of the person;
- Some checks did not agree with the support provided. For example, check number 1042 dated August 10, 1999 was for \$156.90, but the invoice was for \$167.30. Check number 1214 dated April 27, 2000 was for \$27.04; however, the supporting invoice was for \$67.00;
- The Association did not establish a chart of accounts to assist in identifying eligible Program costs and income by budget line item. Since a chart of accounts was not established, there were no monthly financial reports prepared listing the Association's assets, liabilities, income, and expenses; and

- The Association did not require that prior months' bank records be kept at the Association's office. Consequently, the Association had to contact its current and former financial institutions for many missing bank account statements that resulted in delays in the audit process.

The Association established a separate bank account for its Block Grant Program funds. However, the Association did not use the account for only Program expenditures. Various checks were issued out of the Block Grant Program bank account for expenses unrelated to the Program. While the Association did not seek reimbursement for these expenses in monthly expense claims for its Block Grant Program, there was usually no information provided to identify the source of the funds used. Examples of this practice included check number 1221 for \$2,985.00 issued in May 2000 from the bank account, and check number 1224 that was issued for \$1,442.00 in June 2000. The problems occurred because the Association's former Board Treasurer lacked knowledge of accounting, and established accounting policies and procedures.

Monthly Expense Reimbursement Requests Were Inaccurate

The Association's monthly expense reimbursement requests were inaccurate. The amounts requested for reimbursement did not always agree with the supporting documents, or no support was provided for listed expenses. Also, monthly reimbursement requests did not always recognize program income. For example, monthly interest income of \$10.27 was received but not reported for the period August through December 2001. The Association made deposits into its bank account designated for the Community Development Block Grant Program without identifying the source of the funds. The following table provides examples of non-identified fund sources.

| Deposit Date | Amount |
|--------------|-----------|
| 3/31/1999 | \$ 700.00 |
| 5/14/1999 | 4,000.00 |
| 5/26/2000 | 4,520.00 |
| 12/21/2000 | 1,000.00 |

As in the following table, there were requests that included ineligible Program expenses while other requests did not include all eligible Program expenses due to budget constraints.

| Month/Year | Amount Claimed | Amount Reimbursed | Eligible Amount | Remarks |
|--------------|----------------|-------------------|-----------------|--|
| April 1999 | \$ 743.56 | \$ 743.56 | \$1,154.52 | Over budget line items. |
| August 2001 | 2,432.45 | 2,432.45 | 2,272.45 | \$160 in loan costs paid in error. |
| October 2001 | 1,798.73 | 1,708.73 | 1,567.95 | \$141 in loan costs paid in error and missing support. |
| May 2002 | 516.63 | 516.63 | 851.60 | Over budget line items. |

Our review of the Association's monthly expense reimbursements identified many months with minor differences between claimed expenses, the City's reimbursements, and eligible Program costs. The following table shows the Program year, budgeted amount, amount

claimed by the Association, amount reimbursed by the City, eligible expenses, and the difference between the City’s reimbursement and the eligible expenses.

| Program Year | Budgeted Amount | Reimbursement Requested | Amount Reimbursed By The City | Eligible Expenses | Difference |
|---------------------|------------------------|--------------------------------|--------------------------------------|--------------------------|-------------------|
| 1998 | \$18,500 | \$ 7,388 | \$ 7,079 | \$ 7,887 | (\$808) |
| 1999 | 18,600 | 18,600 | 18,500 | 18,537 | (\$37) |
| 2000 | 18,800 | 18,800 | 18,800 | 18,746 | \$54 |
| 2001 | <u>19,176</u> | <u>20,525</u> | <u>19,089</u> | <u>19,173</u> | <u>(\$84)</u> |
| Totals | <u>\$75,076</u> | <u>\$65,313</u> | <u>\$63,468</u> | <u>\$64,343</u> | <u>(\$875)</u> |

The Association had sufficient eligible Block Grant Program expenses for reimbursement from the City’s Program. The above table shows that \$875 more in eligible expenses than what was reimbursed by the City. The additional eligible expenses were due to budget overruns that could not be reimbursed. However, the Association did not adequately account for its Block Grant Program funds in full compliance with Federal requirements due to the Association’s lack of complete and accurate accounting records. The problems occurred because the Association’s former Board Treasurer lacked: (1) an adequate segregation of assigned duties; (2) a knowledge of accounting principles; and (3) established accounting policies and procedures.

According to the Association’s Bylaws, its Board Treasurer had the following duties:

- Handle all financial transactions in a timely manner;
- Deposit all monies in designated depositories;
- Keep accurate records of all financial transactions;
- Provide both oral and written reports to the Board;
- Prepare an annual budget required by funding agencies; and
- Make expenditures up to a set limit without prior board approval.

The City also noted the lack of segregation of duties as an accounting weakness in its November 9, 2001 monitoring review of the Association. Because the Board Treasurer is a volunteer position, the Association should have someone other than its Treasurer perform the following tasks: (1) record keeping; (2) annual budget preparation; and (3) bank reconciliation. The Association’s Bylaws should be amended to reflect the changes.

The Association’s former President said the former Board Treasurer was responsible for preparing the monthly expense reimbursement requests, but the Association did not have its own accounting system. Therefore, the Association relied on whatever means were available to the Board Treasurer to complete his duties. This was complicated by the fact that there was considerable turnover of the Board Treasurer’s position since 1999 because it was a volunteer position with many responsibilities. However, the Association had not prepared any written policies or procedures for the Board Treasurer. Consequently, monthly expense reimbursement requests to the City varied in form, content, and accuracy.

AUDITEE COMMENTS

We provided our draft finding to Oakwood Neighborhood Association's former President, the City's Neighborhood Development Manager of Community Planning and Development, and HUD's staff during the audit. The Association's Treasurer and the City's Neighborhood Development Manager provided their comments on the draft finding on March 13, 2003 and March 26, 2003, respectively.

We held an exit conference with the Association's current President and the City's Neighborhood Development Manager on March 14, 2003. We included both the City and the Association's comments in the Appendix of this audit memorandum report. We provided a copy of this memorandum report to the City's Neighborhood Development Manager and the Association's current President.

[Excerpts paraphrased from the comments provided by the Association's Board Treasurer on our draft audit finding follows. Appendix A, pages 12 and 13, contains the complete text of the comments for the finding.]

The Oakwood Neighborhood Association receives a small amount of funding. Therefore, the Association is dependent upon volunteers for all Board positions, including its Treasurer. As with many instances when utilizing volunteers, accountability in job performance is difficult. However, the Association recognizes the need for accuracy in accounting records and the utilization of professional resources to eliminate mistakes and maintain accurate records. The following changes in our financial policy were approved at the Association's March 2003 meeting and will be implemented within 60 days.

The Board Treasurer will maintain on-site the necessary and accurate accounting records utilizing a checkbook program such as Quicken. The Treasurer will provide written documentation in a consistent format to the Association monthly and the City bi-monthly. The Treasurer will maintain all monthly bank statements, cash receipts, and source documents on-site and in the same location as the checkbook. All tax record keeping and preparation will be handled by an outside source.

The Association is now utilizing a consistent reporting format and the City has not informed us of any problems or inconsistencies with our monthly expense reimbursement requests. All Board members responsible for errors during the time frames cited in the draft report are no longer in office.

OIG EVALUATION OF AUDITEE COMMENTS

The actions planned by the Association, if fully implemented, should improve its accounting procedures and controls over the Community Development Block Grant Program.

RECOMMENDATIONS

We recommend that HUD's Director of Community Planning and Development, Detroit Field Office, requires Oakwood Neighborhood Association to:

- 1A. Implement procedures and controls to: segregate the accounting duties over the Program to the extent practical; maintains bank and accounting records on-site (cash receipt and disbursement journals, general ledger, and source documents); and provide periodic financial reports to its Board.

We also recommend that HUD's Director of Community Planning and Development, Detroit Field Office, requires the City of Kalamazoo to:

- 1B. Discontinue providing Community Development Block Grant Program funds to the Association until it develops and maintains: written accounting procedures; source documents; chart of accounts; cash receipts and disbursements journal; general ledger; and segregates the duties over the Program.

MANAGEMENT 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 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 during our audit of Oakwood Neighborhood Association's Community Development Block Grant Program.

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 were significant weaknesses:

- Program Operations

Oakwood Neighborhood Association's Community Development Block Grant Program was not operated according to Program requirements. Specifically, the Association: (1) did not maintain necessary and accurate accounting records; and (2) submitted monthly expense claims to the City that were inaccurate (see Finding).

- Validity and Reliability of Data

Oakwood Neighborhood Association did not maintain accurate, current, and complete financial records for its Community Development Block Grant Program (see Finding).

- Compliance with Laws and Regulations

Oakwood Neighborhood Association did not follow HUD's regulation and/or Office of Management and Budget Circular A-87 regarding: maintaining a financial management system that provides accurate, current, and complete disclosure of the financial results of its Community Development Block Grant Program; and ensuring that Program funds were adequately accounted for by maintaining adequate accounting records (see Finding).

FOLLOW-UP ON PRIOR AUDITS

This was the first audit of Oakwood Neighborhood Association by HUD's Office of Inspector General. Since the Association received less than \$300,000 in Federal funds, it was exempt from annual audit requirements. The Association is covered under the City of Kalamazoo's Single Audit Report. The latest Independent Auditor's Report for the City of Kalamazoo covered the period ending December 31, 2001. The Report contained no findings.

AUDITEE COMMENTS

**Oakwood Neighborhood
Association**

3320 Laird Kalamazoo, Michigan 49008

March 13, 2003

Mr. Thomas Towers
Assistant Regional Inspector General for Audit, Region V
U.S. Department of Housing and Urban Development
Patrick McNamara Federal Building
477 Michigan Avenue, Room 1790
Detroit, Michigan 48226-2592

Dear Mr. Towers:

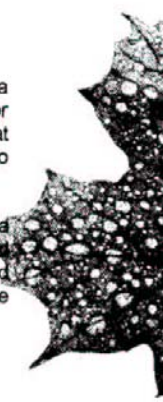
I am writing in response to the draft audit finding report sent to us on March 7, 2003. Because of Mr. Lovelace's recent resignation, our new president is Mr. Gary Wager. Mr. Wager is not as familiar with the finances due to the recent transition, so I will be responsible for correspondence between the O.N.A. and your office. I have held the treasurer position since August, 2002 and am unfamiliar with many of the details stated in the letter. I will try to be as helpful as possible.

Because of the small funding that Oakwood Neighborhood Association receives, we are dependent upon volunteers for all board positions, including treasurer. As with many instances when utilizing volunteers, accountability in job performance is difficult. However, we recognize the need for accuracy in accounting records and utilization of professional resources to eliminate accounting mistakes and maintain accurate records. The following changes in our financial policy were approved at our March meeting and will be implemented within 60 days.

1. The treasurer shall maintain on site, necessary and accurate accounting records utilizing a checkbook program such as Quicken and will provide written documentation in a consistent format, to the O.N.A. monthly and to the City bi-monthly.
2. The treasurer shall maintain all monthly bank statements, cash receipts and source documents on site and in the same location as the checkbook.
3. All tax record keeping and preparation will be handled by an outside source.

I believe it is worth mentioning that since my acceptance of the treasurer position, we have utilized a consistent reporting format and the City of Kalamazoo has not informed us of any problems or inconsistencies with our monthly expense reimbursement requests. I would also like to emphasize that any/all board members responsible for errors during the time frames mentioned in the draft are no longer in office.

The Oakwood Neighborhood Association has made significant progress, in recent months, toward a more professional and informed board membership. This includes board/workshop training and examination/change of policies and by-laws. All of our current board members are dedicated volunteers, many of whom hold full time jobs in addition to this community service they donate. The




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March 13, 2003

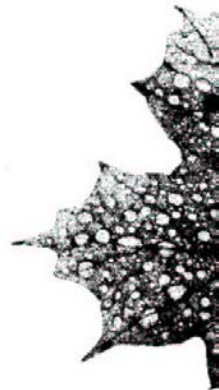
O.N.A. Board has a strong desire to comply with the requests/requirements you suggested and because of this I strongly urge you to reconsider your recommendation regarding our eligibility for Community Development Block Grant Program funding.

I would be pleased to meet with Mr. Brazier in the near future and welcome an opportunity to talk with him personally. I thank you for the opportunity to furnish comments on the draft and encourage you or Mr. Brazier to contact me for any further information.

Sincerely,



Gail Shirey
Treasurer
Oakwood Neighborhood Association





**Community Planning and Development
Neighborhood Development**

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26 March 2003

Mr. Thomas Towers, Assistant Regional Inspector General for Audit, Region V
U.S. Department of Housing and Urban Development
Patrick McNamara Federal Building
477 Michigan Avenue, Room 1790
Detroit, MI 48226-2592

**SUBJECT: Oakwood Neighborhood Association – Audit Finding
Response**

Dear Mr. Towers:

Thank you for the opportunity to comment on the draft audit finding report dated March 7, 2003 and received in my office on March 12, 2003.

I participated in an exit interview conducted by David Brazier at the offices of the Oakwood Neighborhood Association on Friday, March 14, 2003, and have been familiar with the programs and services of the Oakwood Neighborhood Association since the fall of 2001.

I am in agreement with the overall findings and recommendations of Mr. Brazier's report. The Oakwood Neighborhood Association has experienced considerable turnover in its volunteer board, has submitted reports and payment requests which have required considerable City staff time to review and correct, and has been involved in some potential conflict of interest issues concerning the organization's Board/staff makeup. These risk factors have placed the Oakwood Neighborhood Association on the City's priority list of agencies to be monitored. As indicated in Mr. Brazier's report, a number of the current recommendations were previously noted in monitoring reviews by City staff as well.

We note the response from Oakwood Neighborhood Association Treasurer, Gail Shirley, and agree that improvements have been made. The previous Board leadership has resigned, and the new Board leadership is seriously enthusiastic about making improvements.

As to the two (2) specific recommendations made in the report, I offer the following:

Thomas Towers
26 March 2003
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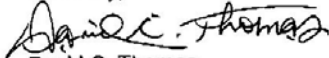
1A. The City of Kalamazoo agrees that the Oakwood Neighborhood Association must develop and maintain (a) written accounting procedures, (b) source documents, (c) a chart of accounts, (d) cash receipts and disbursement journal, and (e) a general ledger. The new Treasurer and leadership at the Oakwood Neighborhood Association have begun the process of enhancing its financial and accounting procedures.

Furthermore, the City of Kalamazoo notes that the Oakwood Neighborhood Association, located in Census Tract number 16.03, is no longer eligible to receive Community Development Block Grant funding under the HUD area benefit category according to the 2000 Census data. Since June 1, 2002, the City of Kalamazoo has been providing operational support for the Oakwood Neighborhood Association through the City's General Fund account. We continue to require the same level of financial accountability and record keeping as recommended in Mr. Brazier's report, and will assist the Oakwood Neighborhood Association in its improvements.

1B. The City of Kalamazoo agrees with the recommendations contained in this paragraph as well, and will assist and offer guidance as practicable. The Oakwood Neighborhood Association has agreed to strive to achieve each of the recommendations listed above, and has agreed to meet with City of Kalamazoo Community Planning and Development staff on June 10, 2003 to review its progress. To document the status of this monitoring, City staff will supply a written report to your office following the June 10 meeting.

Thank you again for the opportunity to comment on the draft audit report.

Sincerely,



David C. Thomas
Neighborhood Development Manager

Cc: Daryle Benjamin-Forbes, Director, Community Planning and Development
Department
Claudette Cobbs, Grants Finance Officer