

# Program Income Performance Audit



**June 2019**

**City of Durham  
Audit Services Department  
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## **AUDIT SERVICES**

CITY OF DURHAM

**Date:** August 26, 2019  
**To:** Audit Services Oversight Committee  
**From:** Germaine Brewington, Director of Audit Services  
**Subject:** Program Income Performance Audit June 2019

The Audit Services Department staff completed the report for the Program Income Performance Audit. The purposes of this audit were to: 1) verify controls over coding/recording of program income; and 2) verify controls over the use of program income.

This report presents the observations and results of the Program Income Performance Audit. Two recommendations were proposed. In response to this Audit's recommendations, City Management concur with the recommendations made. The detailed Management Response to the recommendations is included with the attached report.

The Department of Audit Services staff would like to acknowledge the contributions of the staff from the Departments of: Community Development and Finance.

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# Audit Report Highlights

## Background

Program income is the gross income received by the City which is directly generated from the use of CDBG funds, HOME funds, Dedicated Housing funds and Bond funds. CDBG funds, HOME funds, Dedicated Housing funds and Bond funds are loaned for property acquisition, housing rehabilitation, down payment assistance or economic development assistance. Program income at the City is generated as a result of payment from borrowers of principal and interest on loans made using these funds. When beneficiaries repay these loans, the money returned is called program income. Program income must be used for eligible activities. The Code of Federal Regulations defines the requirements for program income generated as a result of using CDBG and HOME funds.

## Purpose

**The purposes of this audit were to:**

- 1) Verify controls over coding and recording of program income; and
- 2) Verify controls over use of program income.

## Why this audit is important

Program income generated from federal funds has regulations that govern its use and recording. It is important to ensure that program income is properly collected, recorded and tracked.

## Highlights

Overall, controls exist to ensure adequate tracking and recording of program income generated from federal funds and City funds. AmeriNat collects loan payments and tracks all necessary information pertaining to the loans that they service for the City. The Community Development Department staff ensure proper recording of program income in the general ledger. In addition, a process exists to ensure delinquent payments are addressed. An area for improvement was noted as it relates to ensuring that all loans given by the City are properly established with AmeriNat for loan management. In addition, program income was used for eligible activities. The Community Development Department staff draws down available program income before drawing down entitlement funds. This practice is in line with HUD requirements as it relates to CDBG and HOME funds. The City did not spend the program income available for use on a timely basis; as a result, program income in the amount of \$459,477 has to be remitted to HUD. While the Community Development Department staff have to remit these funds, they will still be able to draw on these funds when expenditures are incurred for eligible activities.

# Audit Services Department

## Internal Audit

The Audit Services Department serves a three-fold role at the City of Durham. Our number one goal is to provide independent, objective assurance that City processes are working effectively. Secondly, we serve as internal fraud examiners when fraud, waste, or abuse is alleged against a City employee or department. Finally, in order to constantly foster high ethical standards, we provide in-depth ethical training to all City employees on a rolling basis. To learn more, visit our CODI site or our page on the [City of Durham's website](#).

## Audit Services Oversight Committee

In order to maintain its organizational independence, the Audit Services Department reports to the Audit Services Oversight Committee (ASOC) at a minimum of four times a year. The ASOC approves all proposed audit plans and completed audits prepared by Audit Services staff.

The Audit Services Oversight Committee is made up of six members: two City Council Members, three resident members, and one alternate City Council Member. The current members include two certified public accountants and persons with business experience. The City Manager is an ex-officio, non-voting member of the ASOC.

## **Audit Services Oversight Committee Members**

### **Chair:**

Maticia Sims, CPA, CIA, CRMA  
*Resident Member*

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Charlie Reece  
*Alternate*  
*City Council Member*

### **Non-Voting Member:**

Thomas J. Bonfield  
*City Manager*

## Background

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The Community Development Department is responsible for coordinating the City's community development and neighborhood stabilization and revitalization efforts including empowerment and home retention, affordable housing, and homelessness services programs. The City implements these services by working with developers and community housing development organizations.

The Community Development Department staff use funds from various sources to achieve its mission: federal grants such as the Community Development Block Grant (CDBG) and HOME Investment Partnership Program (HOME); City Dedicated Housing funds and Bond funds. Program income is the gross income received by the City which is directly generated from the use of these funds. The City generates program income by loaning CDBG funds, HOME funds, Dedicated Housing funds and Bond funds for property acquisition, housing rehabilitation, down payment assistance or economic development assistance. Program income at the City is generated as a result of payment of principal and interest on loans made using these funds. When beneficiaries repay these loans, the money returned is called program income. Program income must be used for eligible activities. The Code of Federal Regulations defines the requirements for program income generated as a result of using CDBG and HOME funds.

HOME: Title 24-Housing and Urban Development, Part 92 – Home Investment Partnership Program Home Funds, sub part K – Program administration 92.503 Program Incomes, Repayments, and Recaptured Funds governs program income.

CDBG: Title 24-Housing and Urban Development, subtitle B. Regulations relating to Housing and Urban Development, Part 570. Community Development Block Grant, subpart J – Grant Administration Section 570.504 Program income governs program income.

### ***Process of monitoring program income***

The City of Durham utilizes AmeriNat Nationwide Loan Servicing to provide loan service functions on the majority of loans made by the City. AmeriNat maintains a complete and accurate account of the borrowers' accounts and properly applies all sums collected from each borrower or collected through the partnering primary lending bank. AmeriNat remits to the City, the total receipt of all principal and/or interest payments paid by the borrower. They also notify the City of all defaults and events of defaults by the borrower. In addition, in previous years the Department's down-payment assistance program provided second mortgage loans to Habitat for Humanity home owners. These loans were guaranteed by Habitat for Humanity and payments due on these loans are collected and remitted to the City by the Habitat for Humanity staff.

The Community Development Department staff track all proceeds received for loans (principle, interest and late fees) and reconcile those entries with the general ledger, AmeriNat records/reports and internal spreadsheets used to track outstanding second mortgage loans guaranteed by Habitat for Humanity. Program income earned from CDBG and HOME funds is also reported into the Integrated Disbursement and Information System (IDIS). IDIS is a nationwide database system used to drawdown and report activities of federal grant programs.

## Objectives

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The objectives of the audit were to:

- 1) Verify controls over coding and recording of program income ; and
- 2) Verify controls over use of program income.

## Scope, Methodology, and Compliance

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### Scope

The scope of the audit included examining the current practices over coding, recording and monitoring of program income.

### Methodology

Audit Services Department staff performed the following procedures to accomplish the objectives of the audit. Staff:

- 1 Identified sources of program income;
- 2 Interviewed Community Development Department staff responsible for tracking/recording program income;
- 3 Reviewed the Code of Federal Regulations detailing program income requirements for HOME and CDBG grants;
- 4 Reviewed the process of recording, tracking and using program income;
- 5 Reconciled program income earned for FY 2019 as of May 2019 to program income recorded in the general ledger;
- 6 Randomly selected a sample of loan payments received from AmeriNat and Habitat for Humanity and verified that loan payments were in accordance with the loan terms;
- 7 Randomly selected a sample of loan agreements from original loan files maintained at the Community Development Department and verified that payments were collected for the selected loans;
- 8 Verified procedures to address delinquent loans;
- 9 Verified the process of ensuring new loan agreements were established for monitoring by AmeriNat;
- 10 Selected a sample of expenditures charged to program income and verified if the expenditures were allowable according to grant guidelines;

During the audit, Audit Services Department staff also maintained awareness to the potential existence of fraud.

## **Compliance**

Audit Services staff conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that Audit Services staff plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. Audit Services staff believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Objective 1 Results Summary

### VERIFY CONTROLS OVER CODING AND RECORDING OF PROGRAM INCOME.

Overall, controls exist to ensure adequate tracking and recording of program income generated from federal funds and City funds. AmeriNat collects loan payments and tracks all necessary information pertaining to the loans that they service for the City. The Community Development Department staff ensure proper recording of program income in the general ledger and Integrated Disbursement and Information System (IDIS). In addition, a process exists to ensure delinquent payments are addressed. An area for improvement was noted as it relates to ensuring that all loans given by the City are properly established with AmeriNat for loan management.

#### Finding 1

##### **Audit Services staff found:**

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*The process to ensure loans given by the City which are transferred to AmeriNat for loan management needs to be strengthened*

Audit Services staff reviewed the process of transferring loan information to AmeriNat to facilitate loan management. In order to ensure collection of program income, information pertaining to loans given by the City should be transferred to AmeriNat for loan management. Currently, risk exists that information about loans given by the City may not get transferred to AmeriNat and therefore loan payments will not be collected resulting in lost program income. At present, roles and responsibilities of staff members are not clearly defined to ensure that all pertinent information is submitted to the staff member responsible for loan administration. The Community Development Department staff are currently updating their Standard Operating Procedures (SOP) to clearly define roles and responsibilities.

*Roles and Responsibilities SOP states that, "It is the Senior Analyst's job to ensure that all documentation is received from the developer and given to the Mortgage Loan Portfolio Administrator to convert the loan to the permanent phase"*

*Project Implementation and Closeout SOP states that, "For loans, the Coordinator will submit documents to the Loan Portfolio Administrator for conversion to a permanent loan".*

In addition, the SOPs do not establish when loans should be set up for monitoring with the Loan Service Provider (at the closing of the loan agreement or at the point of loan conversion from a construction to a permanent loan). Most of the Community Development Department's loan agreements are forgivable construction to permanent loan agreements. Per the SOPs it appears that loan documents will be submitted to the Loan Portfolio Administrator only after conversion of the loan agreement from its construction phase to a permanent loan. The SOPs do not state that once loan closing documents are completed they should be submitted to the Loan Portfolio Administrator. The draft SOP on Contract and Loan Document Preparation states that, "The Project Manager will also be responsible for preparing the loan closing documents, which include the deed of trust, promissory note and restrictive covenants." The SOPs also do not outline what documents or information should be submitted to the Loan Portfolio Administrator. The loans should be set up in the AmeriNat system when all information on the loan closing is available and not when the loan converts to the permanent loan from the construction loan.

## **Objective 2 Results Summary**

### **VERIFY CONTROLS OVER USE OF PROGRAM INCOME**

Overall, program income was used for eligible activities. The Community Development Department staff draw down available program income before drawing down entitlement funds. This practice is in line with HUD requirements as it relates to CDBG and HOME funds. The City did not spend the program income available for use on a timely basis. Program income in the amount of \$459,477 for CDBG has to be remitted to HUD. Although the Community Development Department staff had to remit these funds, the staff will be able to draw on these funds when expenditures are incurred for eligible activities.

## Finding 2

### **Audit Services staff found:**

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*Program Income generated from CDBG funds has to be remitted to the Department of Housing and Urban Development (HUD)*

The CDBG entitlement regulations at 24 CFR 570.504(b)(2)(iii) provide that at the end of each program year (June 30), grantees may not have program income on hand in an amount that is more than one-twelfth of the most recent grant. The regulation also states that the amount in excess of the one-twelfth threshold will be remitted to HUD. Analysis performed by HUD staff indicated that the City had excess program income on hand. Excess program income in the amount of \$459,477 must be remitted to HUD because the City did not spend the program income available for use on a timely basis. The Community Development Department staff will be able to draw on these funds when expenditures are incurred for eligible activities. Returning excessive program income will result in lost interest income on this amount and could also potentially impact the entitlement funds made available to the City in the future.

*Excessive program income of \$459,477 must be remitted to HUD. However, the funds are still accessible to the Community Development Department for future use on eligible activities.*

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## Conclusion

Overall, controls exist to ensure adequate tracking and recording of program income generated from federal funds and City funds. AmeriNat collects loan payments and tracks all necessary information pertaining to the loans that they service for the City. The Community Development Department staff ensure proper recording of program income in the general ledger. In addition, a process exists to ensure delinquent payments are addressed. An area for improvement was noted as it relates to ensuring that all loans given by the City are properly established with AmeriNat for loan management. In addition, program income was used for eligible activities. The Community Development Department staff

draw down available program income before drawing down entitlement funds. This practice is in line with HUD requirements as it relates to CDBG and HOME funds. The City did not spend the program income available for use on a timely basis; therefore, program income in the amount of \$459,477 has to be remitted to HUD. The Community Development Department staff will be able to draw on these funds when expenditures are incurred for eligible activities.

# Recommendations

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## Recommendation 1

The Community Development Department staff should ensure that standard operating procedures:

- Define the staff responsible for submitting loan information to the Loan Portfolio Administrator to facilitate loan monitoring;
- Establish when the loan should be set up for monitoring with the Loan Service Provider ( at the closing of the loan agreement or at the point of loan conversion from the construction loan to a permanent status); and
- Outline all necessary documents/information required to be submitted to the Loan Portfolio Administrator for loan monitoring.

**Value Added:** Risk Reduction

## Recommendation 2

The Community Development Department staff should ensure that program income funds are spent timely if feasible to avoid repercussions of maintaining excessive program income at the end of the program year pursuant to the Community Development Block Grant (CDBG) entitlement regulations at 24 CFR 570.504(b)(2)(iii).

**Value Added:** Risk Reduction

### Value Added Legend



To learn more, visit our website at: [durhamNC.gov/audit](http://durhamNC.gov/audit)

# Management Response



**Memo to:** Dr. Germaine F. Brewington, Director of Audit Services  
**From:** Reginald J. Johnson, Director Community Development Department  
**Date:** August 12, 2019  
**Subject:** Management's Response to Recommendations  
Program Income Performance Audit June 2019

The following is the management's response to the Program Income Performance Audit dated June 2019.

## **Recommendation 1:**

The Community Development Department (CDD) staff should ensure that standard operating procedures:

- Define the staff responsible for submitting loan information to the Loan Portfolio Administrator to enable loan monitoring;
- Establish when the loan should be set up for monitoring with the Loan Service Provider (at the closing of the loan agreement or at the point of loan conversion from the construction loan to a permanent status); and
- Outline all necessary documents/information required to be submitted to the Loan Portfolio Administrator for loan monitoring.

**Value Added:** Risk Reduction

## **Management's Response:**

We concur. Management is in full agreement with the recommendation.

The following process updates were in motion as this audit began and CDD appreciates Audit's recommendations and CDD was also please to understand that CDD was on the right path:

- The Loan Portfolio Administrator (LPA) will be responsible for ensuring the implementation of the recommendations. The LPA will be invited to and required to participate in all Request for Proposals or contract startup meetings pertaining to loans.

- If the contract is a transition of a construction to permanent loan, the Project Manager will request the documents needed to convert to permanent loan from the vendor. The Community Development Coordinator (Coordinator) will do a final review of the project files.
- For homeowner or developer loans, the Coordinator will also submit original loan documents to the Loan Portfolio Administrator for loan file set-up with the contracted Loan Servicing Provider.
- The Coordinator will complete the Loan Set-Up Form and use it as the cover sheet with the required documents to hand off the loan documents to the Loan Portfolio Administrator. At contract close or when appropriate, the Project Manager, Coordinator, Compliance Team, and Loan Portfolio Administrator will agree on transfer of documents to offsite retention.
- Closure on these updates to the CDD procedures should be finalized by September 30, 2019.

## **Recommendation 2**

The Community Development Department staff should ensure that program income funds are spent timely if feasible to avoid repercussions of maintaining excessive program income at the end of the program year pursuant to the Community Development Block Grant (CDBG) entitlement regulations at 24 CFR 570.504(b)(2)(iii).

**Value Added:** *Risk Reduction*

### **Management's Response:**

We concur. Management is in full agreement with the recommendation.

The department has already put the following procedures into action:

- The department will monitor projects monthly to ensure invoices for expenditures are being submitted timely by the vendors and to confirm projects are moving as planned.
- Ensure additional programs are included in the Annual Action Plan to serve as back-up if projects are stalled or are not progressing as planned due to project delays.

## Distribution of Report

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