

H. CARL McCALL
STATE COMPTROLLER



A.E. SMITH STATE OFFICE BUILDING
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE
COMPTROLLER

April 29, 1999

Mr. Joseph Lynch
Commissioner
Division of Housing and Community Renewal
Hampton Plaza
38-40 State Street
Albany, New York 12207

Re: Oversight of Citizens'
Opportunity for Development
and Equality, Inc.
Report 97-S-61

Dear Mr. Lynch:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance law, we have audited selected aspects of the Division of Housing and Community Renewal's oversight of Citizens' Opportunity for Development and Equality, Inc. (CODE). Our audit covered the period January 1, 1993 through February 13, 1998. Follow up work resulting from CODE's response to our preliminary findings continued until October 2, 1998.

A. Background

CODE is a not-for-profit, neighborhood preservation company established in 1981 to promote revitalization activities in low-income neighborhoods and to develop and operate low-income rental housing units in Jamestown, New York. CODE is funded by the Federal government, New York State, the City of Jamestown, and other private sources. CODE is staffed by an Executive Director, a Housing Development Director, an apartment manager/receptionist and a maintenance worker.

The New York State Division of Housing and Community Renewal (DHCR) administers Federal and State loans and grants for the construction, rehabilitation and preservation of low-income housing and provides administrative funds to the State's nearly 300 rural and neighborhood preservation companies. DHCR reviews proposals and awards grants to housing companies, monitors their construction/rehabilitation budgets and progress and provides technical and administrative assistance.

DHCR's administrative responsibilities pertain to such housing programs as the State Low Income Housing Trust Fund Program and the Federal Low Income Housing Tax Credit and HOME Programs. DHCR is responsible for ensuring that CODE's participation complies with regulations for the programs. DHCR has provided oversight for all eight construction projects CODE has developed between 1992 and 1998. Each of these projects was generally supplemented by governmental and private grants and commercial loans. DHCR provided the greatest amount of funding for each of the projects.

During the two years ended December 31, 1997, DHCR approved construction projects with budgets totaling about \$5.3 million for CODE to develop two multi-unit housing projects, Dexterville and Euclid Gardens. Of this amount, \$898,000 is to be provided by the State Housing Trust Fund Program, \$3,400,000 is to be provided by an allocation of federal tax credits funded or to be funded by third-party private investors, \$785,000 is to be provided by other federal sources, and \$240,000 is from other sources. DHCR officials told us that the Euclid Gardens project involves an old school with a historical designation. According to the officials, historical projects create additional requirements which frequently result in higher costs per unit. In addition to construction project funding, CODE receives additional grants to fund administrative costs. For example, CODE receives an annual grant of \$65,000 from DHCR's Neighborhood Preservation Corporation Program, and a bi-annual grant of \$50,000 from the Federal government.

As part of its overall compensation package to its managers, CODE has been paying bonuses to its Executive Director and Housing Director since 1993, when CODE's Board of Directors authorized such payments and set up guidelines for them. CODE's Chairman of the Board informed us that the Board decided to pay bonuses to its executive management as an incentive for them to gain additional grant funding for CODE. According to the Chairman, the bonus is a performance-based payment equal to one percent of the funding obtained from a successfully completed construction project plus an amount equal to the income tax attributable to the payment, provided that such payments do not impair the financial solvency of CODE. CODE has paid its executive management a total of \$64,378 in bonuses between calendar years 1993 and 1997.

CODE pays the bonuses from the developer's fee that housing companies earn upon completion of a project. According to a DHCR program guide, the developer's fee is based upon 10 percent of the acquisition and improvement costs associated with the low income portions of the project and is defined as compensation for services, overhead and profit. A budget line for the developer's fee is usually included in the budgets that neighborhood preservation companies submit to DHCR in order to receive grants to rehabilitate low-income housing units. These budgets can

include multiple sources of funding, including Federal, State and private monies. According to DHCR officials, a housing company is allowed to keep the entire budgeted developer's fee if the project costs do not exceed the budget. Therefore, CODE may pay bonuses to its Executive Director and Housing Development Director from the profit included in the developer's fee.

B. Audit Scope, Objectives and Methodology

We audited selected operating practices at CODE and DHCR's monitoring of those practices for the period January 1, 1993 through February 13, 1998. Follow up work resulting from CODE's response to our preliminary findings continued until October 2, 1998. The objectives of our performance audit were to determine if selected CODE operating practices were adequate and if DHCR provided adequate oversight over the selected practices. To accomplish our objectives, we interviewed DHCR and CODE officials, reviewed DHCR monitoring procedures and reports, and examined CODE program and expenditure records.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our review to adequately assess those operations of CODE and DHCR which are included in our audit scope. These standards require that we review and report on DHCR's and CODE's internal control structure and compliance with those laws, rules and regulations that are relevant to those operations included in our audit scope. Our audit included examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we considered necessary in the circumstances. Our audit also included assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, finite audit resources are used to identify where and how improvements can be made. Thus, little audit effort is devoted to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

C. Results of Audit

In January 1993, DHCR received a letter from a concerned party who questioned CODE's contract awarding practices. CODE received a similar correspondence from another party in February 1993. DHCR officials told us that they met with CODE officials at a Board meeting in April 1993 to discuss CODE's bidding procedures and potential conflicts of interest. While no minutes exist to support the Board meeting results, DHCR officials told us that they instructed CODE to "seek competition." However, in September 1996, an additional complaint was made regarding a potential conflict of interest at CODE. Our audit shows that CODE has not sought competition,

as instructed by DHCR, and DHCR has not acted to ensure that CODE resolved this longstanding issue appropriately in accordance with Federal and State regulations.

We found that CODE paid \$78,183 to the Executive Director's son between October 1994 and August 1997 to perform landscaping, demolition and concrete work arising from a five-year general maintenance contract awarded in 1993 and from five housing projects CODE developed since 1994. The work was awarded directly by CODE to the Executive Director's son with the exception of one instance where the work was awarded indirectly through CODE's general construction contractor.

Sections 1901.2 and 2601.3(b) of the New York State Housing Trust Fund and Neighborhood Preservation Companies Rules and Regulations addressing conflict of interest state that the immediate families of persons who are employees of recipient organizations shall not receive any compensation from a recipient organization, directly or indirectly, for goods or services pursuant to an award or contract, unless a good faith effort to obtain competitive prices is made. The regulations further state that the results of such efforts should be reported by the recipient organization to DHCR in writing, and DHCR should base approval on comparison to arm's length transactions and the needs of the project. However, we found that CODE did not report to DHCR about its efforts to seek competition.

In addition, other Federal and State regulations specify the course government agencies should follow to avoid actual or potential conflicts of interest and the appearance of impropriety in the awarding of contracts. For example, Low Income Housing Tax Credit Federal regulations (IRC Section 2040) state that a potential conflict of interest exists when a program recipient awards contracts to a family member. The regulations require program recipients to submit an affidavit disclosing the conflict of interest.

Federal regulations of the Home Program (24 CFR Section 92.356), which CODE participates in, state that any person who is an employee of the recipient receiving Home funds, and who is in a position to participate in the decision-making process or gain inside information with regard to recipient activities, may not have an interest in any contract, subcontract or agreement for themselves or those with whom they have family ties. The Federal grantor agency, Housing and Urban Development (HUD), may grant an exception, on a case-by-case basis, only after the recipient has provided disclosure of the nature of the conflict, assured that there has been public disclosure of the conflict, given a description of how the public disclosure was made, and provided an opinion of the recipient or State recipient's attorney that the interest for which the exception is sought would not violate State or local law.

Since 1989, CODE officials have disclosed the father-son relationship in a form letter which was sent to DHCR each time CODE received a grant, as required by the Low Income Housing Tax Credit Federal regulations mentioned previously. However, DHCR apparently did not take any further action to address the situation as required by the other various Federal and State regulations. We also note that DHCR has not developed procedures to provide a framework to appropriately

resolve conflict of interest situations that may occur and to ensure compliance with relevant regulations. This lack of procedures may have contributed to the longstanding potential conflict of interest at CODE. We believe it is incumbent upon DHCR officials to resolve this issue at CODE to ensure that no actual or potential conflict of interest exists in current contracts. Further, DHCR should require that CODE provides an opportunity for all interested contractors to participate in the contract bidding process in the future.

Competitive bidding procedures help to ensure widespread participation by contractors who will compete to offer the best price. We noted that the Executive Director's son was paid for landscaping work he performed for six housing projects developed by CODE. However, CODE did not place an advertisement for the landscaping work in a general publication for any of these six projects, and solicited proposals from only selected vendors for one landscaping project.

We also found that for maintenance work performed by the Executive Director's son, CODE did not maintain records to verify that the work was in fact performed. In addition, we noted that CODE did not maintain a dual signature system for issuing any of its checks. Many CODE checks made out to the Executive Director's son were signed by the Executive Director only.

Recommendations

1. *Resolve, in accordance with applicable laws and regulations, the potential conflict of interest that exists at CODE between the Executive Director and his son.*
2. *Develop procedures for grant recipients to follow to ensure that potential conflict of interest are appropriately resolved in accordance with applicable laws and regulations.*
3. *Direct CODE to maintain documentation supporting the satisfactory completion of all work for which the Executive Director's son is paid.*

A draft copy of this report was provided to DHCR and CODE officials for their review and comment. Comments were received from DHCR officials and these have been considered in the preparation of this report and are included as Appendix A. DHCR officials have advised us that all three of our recommendations will be implemented.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of DHCR shall report to the Governor, the State Comptroller and leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this report were Howard Feigenbaum, Karen Bogucki, Marcia Petersen, Michael Wrobel and Marti Madory.

We wish to thank the management and staff of DHCR and CODE for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Jerry Barber
Audit Director

cc: Mr. Donald Bloomquist Sr.
Mr. Charles Conaway

George E. Pataki
Governor



Joseph B. Lynch
Commissioner

New York State Division of Housing and Community Renewal

Hampton Plaza
38-40 State Street
Albany, NY 12207

April 19, 1999

Mr. Jerry Barber
Audit Director
Office of the State Comptroller
A. E. Smith State Office Building
Albany, New York 12216

Dear Mr. Barber:

We appreciate the efforts of your auditors in the review of the matters relating to our enforcement and application of conflict of interest provisions. Please be advised that the Division of Housing and Community Renewal will undertake a review of its conflict of interest requirements and insure that the controls established meet all statutory and regulatory provisions. Each of the three recommendations will be implemented.

Sincerely,

A handwritten signature in cursive script that reads "John J. Solodow".

John J. Solodow
Internal Control Officer

Cc: Joseph B. Lynch, Commissioner
S. Hicks, First Deputy Commissioner
R. Rock, DoB
N. Reuss, DoB
J. Calogero, Deputy Commissioner