

***State of New York
Office of the State Comptroller
Division of Management Audit
and State Financial Services***

**DIVISION OF HOUSING AND
COMMUNITY RENEWAL**

**HARRY SILVER HOUSING COMPANY
SELECTED FINANCIAL AND
MANAGEMENT PRACTICES**

REPORT 97-S-41



H. Carl McCall
Comptroller



State of New York Office of the State Comptroller

Division of Management Audit and State Financial Services

Report 97-S-41

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

Dear Mr. Lynch:

The following is our report addressing selected financial and management practices of the Harry Silver Housing Company and the Division of Housing and Community Renewal's procedure for monitoring those practices.

This audit was performed 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. Major contributors to this report are listed in Appendix A.

*Office of the State Comptroller
Division of Management Audit
and State Financial Services*

April 9, 1999

Executive Summary

Division of Housing and Community Renewal Harry Silver Housing Company Selected Financial and Management Practices

Scope of Audit

The New York State Division of Housing and Community Renewal (DHCR) is responsible for formulating State policy for housing development and financing, maintaining the State's low-and middle-income housing stock, and providing communities with technical assistance in housing and community revitalization. DHCR oversight includes the Limited Dividend program, which was created by Article IV of the Private Housing Finance Law. Publicly-financed housing projects built under the Limited Dividend program are owned and operated by private housing companies. Some of the companies oversee daily operations at their projects, while others contract with managing agents to provide daily oversight. The program currently has ten developments, including the Harry Silver Housing Company (Company) in Brooklyn that encompasses 288 cooperative apartments of varying sizes. The Company's annual operating expenses are \$1.58 million. The project's resident cooperators elect a nine-member Board of Directors (Board), who in turn elect officers from among their membership. The Company's Board members generally have full-time jobs of their own in addition to Board responsibilities. In recent years the Company has replaced several managing agents because of problems with the performance of the agents.

Our audit addressed the following questions about selected aspects of the Company's financial and management practices for the three years that ended on December 31, 1997:

- Has the Company established adequate internal controls over expenditures and revenues for this project?
- Has DHCR provided adequate oversight of the Company's financial and management practices?

Certain of the financial and management practices we examined had a history that preceded the current Board Members and the three years covered by our audit.

Audit Observations and Conclusions

While no one of our findings by itself appears to be critical, the findings nevertheless present opportunities for improving Company internal controls. We recognize that strengthening controls can be difficult given the time constraints on Board members and the frequent changes in

managing agents. We believe, however, that our report provides details that can help the Board and the managing agent to ensure that the Company has adequate controls.

Collection of Company revenues is within the scope of the managing agent's duties. However, one Board member had assumed this function by managing, collecting, and disbursing fees paid by the cooperators to rent the Social Club Room. The member had acted without the approval of the Board, the managing agent, or DHCR officials. We also noted that cooperator accounts receivable exceeded \$190,000, an increase of 42 percent over the amount reported in 1992. Formalized procedures for collecting accounts receivable were not in place, and eviction proceedings were generally not pursued against cooperators who had large arrearages. (See pp. 9-12)

DHCR's monitoring of the Company's operations, has not resulted in adherence to proper procedures. When we reviewed the Company's apartment-leasing procedures, we found that units had been leased to residents whose names had not been on the official waiting list, apartments were being occupied without the required DHCR approval, residents' files did not contain the required official documents, and the Company had not always forwarded the minutes of monthly Board meetings to DHCR, as required. (See pp. 15-18)

We also noted that a written policy and procedures manual, in which the Company was supposed to state proper management procedures, was not available. (See p. 18)

Comments of DHCR Officials and Harry Silver Board Members

DHCR officials agree with our findings and recommendations. They state that, until recently, the Company has not responded to many of DHCR's corrective recommendations. The Harry Silver Housing Company Board of Directors indicated that the Board was working with the new managing agent to resolve past problems. The Board also responded that many of the problems cited in our report occurred before the current Board took office. In addition, the Board stated that a spirit of cooperation with the presently assigned DHCR representative can hopefully work towards making Harry Silver a viable and happy corporation.

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Major Contributors to this Report

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Comments of DHCR Officials and Harry Silver Board Members

Introduction

Background

The New York State Division of Housing and Community Renewal (DHCR) is responsible for formulating State policy for housing development and financing, maintaining the State's low-and middle-income housing stock, and providing communities with technical assistance in housing and community revitalization. DHCR's responsibilities include supervision of the State-financed Limited Dividend program, which was created by Article IV of the Private Housing Finance Law. The developers of Limited Dividend projects obtained tax abatements and private funding to build their projects more than 40 years ago. In most cases, the abatements have now expired.

The operation of a Limited Dividend housing project is governed by Section 1700 of the New York State Codes, Rules and Regulation (Code). Each Limited Dividend housing project is owned and maintained by a private housing company. Some of these companies also oversee daily operations at their projects, while others contract with independent managing agents for daily oversight. Of the 22 Limited Dividend projects that have been constructed, 10 are still in the program, including the one operated by the Harry Silver Housing Company (Company). The Company's project encompasses 288 cooperative apartments of varying sizes located in the Crown Heights section of Kings County (Brooklyn). The resident shareholder cooperators elect a nine-member Board of Directors (Board), who in turn elect officers from among their membership. The Board contracts with a managing agent, who is responsible for the daily operations of the development; and an accountant, who is responsible for certifying the financial statements. As of August 1997, the Company had annual operating expenses of \$1.58 million, including an annual payroll cost of \$206,000 for a seven-person maintenance staff.

Audit Scope, Objectives, and Methodology

We audited selected financial and management practices at the Company and DHCR's procedures for monitoring those practices for the period January 1, 1995 through December 31, 1997. Certain of the financial and management practices we examined pertain not only to these three years, but also to prior periods and prior Boards. One objective of our audit was to evaluate the appropriateness of the selected financial and management practices of the Company in the areas of expenditures, revenues, and apartment occupancy. Another objective was to assess the effectiveness of DHCR's oversight of the Company's procedures. To accomplish these objectives, we reviewed applicable laws, policies, and procedures. We also interviewed Board members, Company cooperators, the managing agent at time of our audit, the Company's Certified Public

Accountant, and DHCR personnel. We examined data and records that were relevant to our audit scope.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of DHCR, the Company, and the Board which are included within the audit scope. Further, these standards require that we understand the internal control structures implemented by DHCR and the Company, as well as their compliance with those laws, rules and regulations that are relevant to those operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe 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.

Internal Control and Compliance Summary

Our consideration of the Company’s internal control structure focused on administrative controls, which are defined as the procedures that are concerned with decision-making processes leading to management’s authorization of transactions. Specific to the Company, these controls would be related to planning, allocation of resources, and subsequent evaluation of resource allocation decisions. Our audit identified material control weaknesses that are described in the report sections entitled “Expenditures” and “Revenues.” We also noted certain other matters involving the internal control structure and its operation as well as matters relating to compliance with laws, rules and regulations that should be addressed by DHCR. These matters are presented throughout the report.

Response of DHCR Officials and Harry Silver Board Members

A draft copy of this report was provided to DHCR officials for their review and comment. Their comments, as well as comments provided by the Board of Directors of the Harry Silver Housing Company, have been considered in the preparation of this report and are included as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Division of Housing and Community Renewal shall report to the Governor, the State Comptroller, and the 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.

Expenditures

The Board contracts with a managing agent, who is responsible for the daily operations of the Company, including the processing of expenditure transactions. These transactions start with a requisition prepared by Board members, the managing agent, or Company employees. The managing agent then prepares purchase orders for the requisitions and submits the orders to vendors. Invoices received from vendors are submitted to the Board for payment approval. Documentation for the expenditures are then sent to the managing agent's main office, where the payment check is prepared. The checks and the supporting documentation are returned to the Company's on-site management office, where two Board members sign the checks for Company issuance. Our examination of expenditure transactions showed numerous instances in which key items of documentation needed to support the appropriateness of the expenditure were missing. In addition, our review of available documentation for certain transactions indicated that funds had been used for other than ordinary Company operations.

Recordkeeping

Section 1725-2.1(b) of the Code focuses on the Board's custodial responsibility for the Company's assets and its obligation to exercise administrative control over expenditures. The Code makes it clear that each Board member is expected to ensure that the Company's operating expenditures are made effectively and economically. In addition, subsection 1725-5.6 requires the Company's housing management records to be retained until DHCR authorizes their destruction.

We reviewed the processing of expenditure transactions from January 1, 1995 through July 31, 1997, for Code compliance. Our review included a judgmental sample of 36 expenditure transactions. Since the Company switched to a different managing agent in February 1997, our sample included 13 expenditure transactions with a total value of \$17,755 for the period January 1, 1995 through January 31, 1997; and 23 expenditure transactions with a total value of \$280,455 for the period February 1, 1997 through July 31, 1997.

Some of the expenditure records for the January 1, 1995 through January 31, 1997 period could not be located in the Company's office. After our unsuccessful efforts to locate these records, we reported the missing ones to the Board President, who then provided us with the Board's copies of these records.

Our sample of 36 transactions included 32 which required a purchase order. Of the 36 transactions requiring an invoice, the invoice was missing for 9 and lacked evidence of approval for 17. Of the 32 transactions requiring a purchase order, the purchase order was missing for 10 and lacked evidence of approval for 7. The absence of these required items is an internal control weakness and a Code violation. These weaknesses, which pertain to both the current and previous managing agents, have increased the risk for inappropriate expenditure transactions.

Response of Board Officials to Audit: In response to our audit, the Board provided additional items and requested that our report be updated accordingly.

Auditors' Comments: The previously discussed statistics about invoices and purchase orders reflects the results of our review of all items provided and replaces a table that we had used in our draft report to illustrate our findings.

Our review noted two canceled checks did not have the two required signatures by Board members. One check was written on April 21, 1997 for \$13,627; the other was written on February 25, 1995, for \$2,051. In addition, we noted that the rubber-stamped endorsement had been crossed out on one canceled check, which had been written for \$1,027 on March 17, 1994, and another handwritten endorsement substituted. We were not able to determine whether the endorsement had been crossed out and substituted before or after the check was paid and canceled. No explanation was offered about how this occurred.

In response to our observations, the Board told us they had repeatedly encouraged managing agent personnel to ensure that all documents be approved properly before they are processed. The managing agent at the time of our audit acknowledged that his staff had been lax in this area and stated that personnel would be more diligent in the future in obtaining the required written authorizations. Subsequently, the Board contracted with a new managing agent.

Response of Board Officials to Audit: Concerning the check for \$13,627, Board officials responded that this was a payment to NYC Water and it had been informally agreed that the managing agent would be allowed to sign utility bills to avoid late payments. Board officials stated that the check for \$2,051 and the check for \$1,027 were payable to two subsidiary companies that shared the same address. Board officials explained that the wrong endorsement was placed on the checks and the mistake was not detected by the bank.

Board officials also stated that it is the Comptroller's responsibility to cite and investigate errors such as this when they occur.

Auditors' Comment: Documentation should be maintained to support when it is acceptable to depart from the established requirement that two Board members sign checks. We did cite and investigate the check endorsement problem. As the report states, we could not determine if the substituted endorsement happened before or after the check was cashed. Ultimately, management is responsible for the accuracy and integrity of its financial records and practices. Apparently, the Board has determined that the endorsement problem was simply a mistake not caught by the bank.

Extraordinary Expenditures

Subsection 1728-2.8 of the Code requires that, except as permitted with the prior written approval of DHCR's Commissioner, the Company's funds are not to be used for any purpose other than ordinary Company operations. We determined that the Board, without DHCR consent, had approved an extraordinary expenditure for bedroom furniture for a shareholder.

In this instance, the shareholder had notified the Board that water leaks in an apartment had damaged bedroom furniture and a rug costing \$3,600 and \$450, respectively. According to the shareholder, the damage resulted from flooding caused by a boiler malfunction. The Board approved an expenditure of \$4,757 to compensate the shareholder for the damaged furniture. Moreover, we found that, in addition to the replacement of the shareholder's furniture with Board approval, a rug had been paid for with \$708 of Company funds, even though Board approval had not been requested or received for the expenditure.

Response of Board Officials to Audit: According to the Board response, this action was taken because the tenant intended to sue and the Board did not want to spend funds and time in court with a case that was not likely to be won.

Auditors' Comment: We reiterate that the Code requires DHCR consent for expenditures such as these. Approval of these expenditures by DHCR could have avoided the appearance of impropriety.

Recommendations

When reviewing Company operations, DHCR should:

1. Ensure that routine Company expenditures are approved and documented properly, and that pertinent documents and files are retained properly.
2. Ensure that canceled checks are reviewed to verify that they have been endorsed properly.
3. Ensure that prior DHCR approval is requested and received for any payments that are outside of ordinary Company operations.

Revenues

According to Subsection 1729-1.2 of the Code, the managing agent is required to handle the fiscal administration of the cooperative, including the collection of revenues. The managing agent is also responsible for maintaining adequate records for all types of revenues. Our examination showed that internal controls over revenues need to be improved.

Social Club Room Fees

The basement of building 810 of the development contains both a Community Room (CR) and a Social Club Room (SCR). In the past, the CR was available for rental by residents for social events. However, this room has been damaged and reportedly has not been in use for some time; while the SCR remains a facility that cooperators can rent for a particular purpose. The SCR is also used as a polling location and for Board meetings. For several years, fees have been collected for the use of this room without proper internal controls or separation of duties, allowing the possibility of financial impropriety.

Subsection 1729-1.2 of the Code requires that the fiscal administration of the cooperative, including the collection of Company revenues and payment of Company obligations, be handled by the managing agent. Therefore, all fees charged for the use of Company property should be collected by the managing agent. Furthermore, any expenditures from Company funds should be processed by the managing agent, with Board approval. The managing agent is responsible for maintaining adequate records for all types of revenues and expenses.

Subsection 1725-3.3 of the Code describes the proper role for a project's Board, stating that the Board "has the responsibility for establishing policy covering the administration of property, interests, business and transactions of the corporation and may delegate to officers such authority as it deems necessary. Sound organization dictates that members of the Board should not interfere with day-to-day management and operation of a project or with its employees or intrude upon management functions."

Our audit found that the Company's managing agent handles neither the fiscal nor the physical operation of the SCR, as required. The current managing agent does not arrange for the use of the SCR, collect fees for such use, or have physical access to the SCR. These duties have been undertaken by one of the Board members who has assumed complete control over this aspect of the Company's operation. None of the relevant Board meeting minutes was furnished for our review of this matter, and the Company By-Laws did not indicate that the Board could grant the

member this authority. There was also no record indicating that the other Board members had approved this arrangement.

The Board member controlling SCR operations was also president of a men's social club whose members frequently used the SCR. Moreover, we found that, although cooperators were required to pay \$200 per event to rent the room, the men's club members could enjoy the same privilege for just \$100. Formal Company records that would account for the fees received for the use of this room were not maintained, and no receipts had been issued. In addition, there were no formal Company records of the room's usage. The Board member who controlled the SCR provided us with his informal list of rentals. This record showed the date, the name of the person renting the room, and the amount collected.

According to the records we reviewed, fees of \$10,925 were collected in cash from August 1994 to April 1997 for the use of the SCR. These funds were not segregated into a separate Company bank account. The Board member, who collected the funds and deposited them to his personal account, told us he had complete control over and exclusive use of the money so he could be assured that all of the revenues generated would be used exclusively to furnish and refurbish the SCR.

The Board member furnished us with a list of expenditures for the same period that totaled \$11,011, and indicated that he had contributed the \$86 differential between revenues and expenses. He had initially made all of the purchases with his personal funds, without the advice or consent of the managing agent or other Board members, and had reimbursed himself with the SCR fees he collected. Most of the items he purchased did appear to be for SCR use, including a large-screen television with a security enclosure and stand, tables, chairs, and an electric cooking range.

A physical observation of the room verified that these items were on site. However, none of the equipment was listed on the Company's inventory of assets. Since these items were purchased with Company revenues, their title should be transferred to the Company. We also noted reported expenditures of \$786 that did not relate directly to use of the SCR, including charitable donations and barbeque equipment.

Because there were no formal bank account records, rental receipts, or logs of receipts and expenditures, we could not verify the accuracy of the reported fees collected or amounts expended. Furthermore, receipts and expenses related to the SCR were not part of the Company's financial statements. The DHCR housing representative had previously noted this situation. A July 1997 letter from DHCR's Housing Management Bureau

had instructed the Board to ensure that all fees received for the SCR were collected in the form of checks made out to the Company.

Both DHCR officials and the managing agent at the time of our audit agreed that the use and control of the SCR should be the managing agent's responsibility and that all residents should be charged the same rate for using the room. They also stated that SCR fees collected in the future would be deposited into the Company's bank account and would be under the managing agent's control. The Board members responded that, while the Community Room should be controlled by the managing agent, they would prefer to retain control over the Social Club Room. They also stated that we should have verified the accuracy of the total reported fees collected during the audit period. We did not pursue verification of collections any further because there were no independent records that would indicate who might have used the room and incurred a fee.

Accounts Receivable

As of September 30, 1997, the Company reported a total of \$190,502 in accounts receivable, including \$102,909 due from current cooperators and \$87,593 due from prior residents. Subsection 1727-4.11 of the Code requires the prompt payment of monthly rents to housing companies. From the time of each prospective cooperator's interview, the managing agent is expected to stress that rent is payable on the first day of the month. The Code further states that if the rent payment is not received promptly, a three-day warning notice is to be served no later than the 10th of the month. At the expiration of the three-day period, the managing agent is to initiate summary proceedings and prepare precept and petition, under supervision of Company counsel. Counsel should then continue the proceeding unless full payment is received. The Code also requires that every effort be made to collect the indebtedness of former residents who still owe unpaid rents.

The managing agent at the time of our audit assumed responsibility for the Company in February 1997, but neither the agent nor the Board determined the accuracy of the accounts receivable records established by the previous agent. While the Board, in response to our report stated that the accounts receivable as of February 1989 reconciled with the treasurer's records, receivable balances that were reported by the former managing agent were simply carried forward. To test the current balances, we selected a judgmental sample of 34 cooperators whose receivables added up to \$80,698, representing about 80 percent of the total as of September 30, 1997. We sent these cooperators positive confirmation requests and asked them to indicate how much of their rent they believed to be outstanding as of that date. Of the 34, we received responses from 13 to either our first or second request. Just 2 of the 13 cooperators agreed

with the amount listed as due. Of the 11 who disagreed, 9 reported that the amount they owed was less than the Company records indicated, with the variance ranging as high as \$4,608. Two reported that they owed more — by as much as \$590 — than the Company records indicated.

These disagreements occurred for a variety of reasons. For example, some of the respondents reported that their overdue rent had been paid; others stated that the amount had been in error and should be adjusted. Still others claimed that they had not been in arrears and did not know why an outstanding balance was listed for them. A similar positive confirmation letter procedure had been undertaken by the Company's Certified Public Accountant (CPA) in August 1997. Of the 48 letters the CPA sent to cooperators, just 6 responded; and none of them agreed with the Company's figures.

Because there are discrepancies between the confirmations and the accounts receivable records, immediate action should be taken to perform a reconciliation so that correct balances can be established. In addition, formalized procedures for conducting eviction proceedings as well as procedures to use collection agents to pursue outstanding debts were necessary to reduce the overall amount of accounts receivable.

Cooperators' rent payments are to be either mailed to a lock box located at the Company's bank or delivered personally to the on-site management office, where the payments are to be either placed in a secured depository in the office, or handed directly to the managing agent. On a daily basis, the checks should be forwarded, unopened, directly to the managing agent's main office. However, the Company often held rent-payment checks on-site for a few days. Thus, the receipts were at increased risk of being lost or stolen. Proper internal controls require that these receipts be forwarded to the main office on a daily basis.

In response to our observations, the managing agent at the time of our audit agreed not to retain funds in the site office overnight. The agent expressed confidence that the current records of accounts receivable outstanding are correct, but conceded that staff had not verified the balances inherited from the previous managing agent in February 1997. While the agent did not believe that there were any errors in the records, he agreed to review the accuracy of each account and to pursue all amounts outstanding. The Board responded that a list of former residents who still owed rents has been placed with a collection agency.

Recommendations

When reviewing Company operations, DHCR should:

4. Ensure that the managing agent takes over the operation of the SCR and that all residents are charged the appropriate approved fee for the room.
5. Ensure that the ownership of all assets purchased with SCR fees is transferred to the Company, and placed in the exclusive control of the managing agent.
6. Ensure that the accounts receivable records are reviewed for accuracy and completeness and that the records of both the Company and residents are reconciled.
7. Ensure that every reasonable effort is made to collect accounts receivable.
8. Ensure that funds collected at the management office are forwarded to the managing agent's main office on a daily basis.

DHCR Monitoring

Section 1729 of the Code requires that DHCR oversee Company procedures. For example, DHCR is required to approve apartment rental decisions; and should review minutes of the monthly Board meetings as well as the Company's certified financial statements. In addition, if necessary, DHCR may initiate hearings to remove Board members or replace managing agents.

Apartment Occupancy Approval

Subsection 1727-1.1 of the Code states that all segments of the public will have an equal opportunity to apply for apartments, and that all applications will be processed in an equitable manner. Subsection 1727-1.3 of the Code states that each application for an apartment is to be accepted promptly, date-stamped consecutively, and issued an application number. In addition, the Company is to maintain a log of current applicants. When an apartment becomes available, applicants are to be notified according to their places on the waiting list. Subsection 1727-1.3 further mandates that companies establish written criteria, policies, and procedures for screening applicants on the waiting list. In addition, Subsection 1727-1.4 of the Code requires the Company to wait for DHCR approval before allowing anyone to occupy an apartment.

We reviewed files for eight apartments to determine whether the current residents had properly obtained the right to occupy their apartments. We found that the residents of three of the apartments had properly obtained their residency. In another case, we could not determine whether the current tenant had obtained residency properly because he had occupied the apartment for such a long time that the list that might have included his name was no longer on file. We found the following exceptions for four of the apartments:

- In two instances, the names of the residents could not be found on the official apartment waiting lists.
- In the third case, the tenant's name appeared on an internal transfer list for established residents. However, when his name was placed on this list he was not a resident of the project.
- In the fourth instance, the tenant's name was on a waiting list for a one-bedroom apartment, but not for the two-bedroom apartment he was being allowed to occupy.

In addition, we could not verify that appropriate occupancy procedures had been followed for five of the eight apartments; in each of these cases, the required DHCR occupancy approval had not been requested and was not on file.

We also received a complaint from project residents that two cooperators had switched apartments without authorization. When we reviewed the files of these two apartments, we found no documentation indicating that DHCR approval had been sought or received for this switch.

Response of Board Officials to Audit: Board officials stated that the two shareholders switched apartments without permission from the Board of Directors, management or DHCR. The shareholders refused all requests to rectify the situation.

Record Preparation

Subsection 1725-5.1 of the Code states that a Company must maintain complete and accurate files to operate effectively. This Subsection also directs DHCR to monitor Company operations. The Code further states that all Company files should be made available for inspection by DHCR representatives upon request; they must not be removed by an officer, agent, employee, or other person to another office, residence, or any other location. Subsection 1725-5.2 of the Code requires that cooperator files be maintained for both current and former residents. Such files are generally maintained according to the reference number of the resident's account or apartment. All forms, letters, reports, lease applications, leases, income surveys, and rent adjustments concerning an individual resident should be kept in these files. Clearly, the Code recognizes that complete residency files are essential to effective DHCR oversight.

We selected a judgmental sample of 57 (20 percent) of the files being maintained for the project's 287 residents and reviewed them to determine whether the required documents were present. Our review revealed that essential documents were missing from the Company's official cooperator files, as indicated in the following table:

Item Missing	Number Missing	Percentage of Sample
Stock Certificate Stub	40	70%
Executed Lease Agreement	17	30%
DHCR Occupancy Approval	23	41%

The absence of such large numbers of essential documents indicates that the Company is not maintaining these files well and is not compliant with

the Code. The lack of such important documentation may hinder the ability of DHCR to provide the required oversight effectively. According to the Board, many of the recordkeeping problems had occurred before 1991, when most of the current members assumed office.

Annual financial statements must be prepared by the Company, certified by an independent CPA, and submitted to DHCR. Section 1729-1.2j of the Code sets forth the guidelines and duties that managing agents are required to perform, including the preparation of financial statements. If the managing agent prepares these statements as required, and the CPA can certify the accuracy of the statements, then the level of control sought by the Code will be in place.

However, we found that the managing agent at the time of our audit did not prepare the financial statements. Instead, the CPA receives financial data from the managing agent and maintains and posts the general ledger. By posting a general ledger from original books of account and then preparing financial statements from these records, the CPA is not acting independently from the Company and is not acting in a manner that complies with the Code. Personnel at the CPA firm explained that they perform these functions because the managing agent's staff generates incomplete records.

DHCR must ensure that future financial statements and financial records are prepared by the managing agent, as required.

Board meetings are generally held on a monthly basis. Subsection 1725-3.5 of the Code requires that the minutes of each Board meeting be forwarded to DHCR within 10 days after the meeting. When we reviewed DHCR's files for the Company, we determined that, for the 31 months between January 1, 1995 to July 31, 1997, we found that the minutes for only five monthly meetings were received and filed. The files contained no Board minutes for the period of January 1, 1995 to December 31, 1996.

After becoming aware that we had inquired about the minutes, the Board President furnished us with a personal copy of the minutes for eight additional meetings covered in our scope period. Furthermore, in response to our inquiries, the managing agent at the time of our audit confirmed that the Company files contained no additional records pertaining to Board minutes prepared during our scope period. Apparently, no minutes were prepared for 18 of the 31 months we reviewed.

This failure to prepare and furnish the required minutes to DHCR increases the risk that significant issues or policies addressed at Board

meetings are not documented and/or available to enable DHCR to monitor the Board's activities as required by the Code.

Responding to our observations, the Board stated that they had instructed the managing agent at the time of our audit to submit all Board minutes promptly to DHCR. He agreed to do so.

Policy and Procedures Manual

Section 1725-1.3 of the Code requires that a written policy and procedures manual setting forth proper Company management procedures be prepared by the Company and approved by DHCR. Such a manual would provide program, policy, and technical information; and would specify the appropriate procedures to be followed. We found that the Company has not prepared such a document for any aspect of its operation. As a result, there is a lack of guidance for transacting Company business. DHCR should ensure that the Company prepares, approves, and adheres to formal manuals for all aspects of its operations.

In response to our observations, the managing agent at the time of our audit agreed that a complete manual would be beneficial and stated that efforts would begin soon to compile a manual that addresses Company operations.

Response of Board Officials to Audit: Board officials stated that the present Board was not apprized that a Policy and Procedures Manual needed to be updated. They stated that it was only within the last two years that this present Board has heard about the need for a "Policy and Procedures Manual."

Auditors' Comment: Since the Code requires a written policy and procedures manual, we believe it is reasonable to expect the Board to be aware of this need.

Also in response to our observations, DHCR officials pointed out that they had previously addressed many of the same issues we raised about Company operations, but the Company had not responded. Officials also said they had continued to address these matters with Company representatives without resorting to the sanctions available to the DHCR Commissioner by statute. Although the ultimate remedy would be to commence action in State Supreme Court seeking appropriate relief, including the appointment of a receiver, they indicated a reluctance to do so, expressing the belief that such an action would not be in the best interest of the State.

Recommendations

When reviewing Company operations, DHCR should:

9. Determine how residents were able to occupy apartments without following proper procedures and without securing DHCR approval. Ensure that such inappropriate assignments do not reoccur.
10. Ensure that all necessary documents and approvals are obtained, and that the Company resident files are kept current and complete.
11. Ensure that the managing agent prepares the financial statements, as required.
12. Ensure that Board minutes are prepared and submitted to DHCR on a timely basis.
13. Ensure that a formal policies and procedures manual for all Company activities is developed, approved, and adhered to.

Major Contributors to This Report

Jerry Barber
Howard Feigenbaum
Tom Trypuc
Gennaro John Petillo
Legendre Ambrose
Clyde Bynoe
Marticia Madory

George E. Pataki
Governor



Joseph B. Lynch
Acting Commissioner

New York State Division of Housing and Community Renewal

Hampton Plaza
38-40 State Street
Albany, NY 12207

December 16, 1998

Mr. Jerry Barber
Director of State Audits
State of New York
Office of the State Comptroller
A.E. Smith Office Building
Albany, N.Y. 12236

Dear Mr. Barber:

Attached are comments by the Division of Housing and Community Renewal regarding draft audit report entitled "OSC Audit of Harry Silver". We agree with the audit findings and recommendations in the report. We also will continue to fulfill our statutory obligations and assist the new managing agents in meeting their commitments. Thank you for the opportunity to comment on this draft report.

Sincerely,

A handwritten signature in cursive script, appearing to read "John J. Solodow".

John J. Solodow
Internal Control Officer

Attachment

cc: Joseph B. Lynch, Acting Commissioner
N. Reuss-DOB
O. Jones
R. McCurnin

DHCR response to OSC audit of Harry Silver:

This is in response to the Office of the State Comptroller's audit findings regarding the operations and oversight of Harry Silver Cooperative Apartments.

Harry Silver Apartments is a Limited Dividend housing company subject to the provisions of Article IV of the Private Housing Finance Law. This cooperative development was constructed in the early 1950's with private financing and received a real estate tax abatement, pursuant to Section 93 of the PHFL. In addition to the recent expiration of the housing company's tax abatement, the original mortgage obligation of the company has been satisfied.

While DHCR's supervision of Limited Dividend housing companies is similar to that performed for Mitchell-Lama (Article II of the PHFL) housing companies - i.e., setting rents and/or carrying charges, approval of contracts, management and financial oversight, etc... An added reason for DHCR mandated supervision of Mitchell-Lama(s) is to protect the State's mortgage investment in such developments. Notwithstanding the lack of a State financial interest in the Limited Dividend housing portfolio of which Harry Silver is part, such developments remain, by statute, subject to DHCR supervision.

As documented by records in our files, DHCR has continued its supervisory role with respect to the operation of Harry Silver Apartments. Over the years deficiencies have been noted by our Housing Management field staff with appropriate corrective recommendations and directives being made. Unfortunately, until recently many of these corrective recommendations have not been responded to by the housing company. We will continue our attempts to address these matters with representatives of Harry Silver, however resorting to extreme sanctions provided this agency pursuant to the statute may not be in the best interests of the State. The ultimate remedy, should the housing company continue to fail to adequately respond to DHCR directives, would be to commence action in State Supreme Court seeking appropriate relief, including the appointment of a receiver. Such an action, when there are no State funds or tax abatements at issue, would divert needed staff resources from other projects where there are State funds at issue.

Additionally, DHCR is presently working with the housing company and a bank to secure a loan for needed capital improvements. As a condition of the loan, DHCR will continue its supervision of Harry Silver Apartments for the next ten (10) years, the anticipated term of the loan.

We agree with the audit findings as the same issues had been previously identified by DHCR and DHCR had taken appropriate action before this audit began. It is the responsibility of the board and the managing agent to ensure that the audit recommendations are implemented. The housing company has recently selected a new managing agent. The audit findings and recommendations will be forwarded to them for implementation. Specifically, in response to the recommendations in the audit report, DHCR will continue to fulfill its statutory obligations and assist the new managing agents in meeting their commitments.

HARRY SILVER HOUSING CO., INC.
BOARD OF DIRECTOR'S RESPONSE TO DRAFT OF AUDIT REPORT
(To be Attached To Final Draft)

OVERVIEW: The Board of Directors has received the Draft of your Audit Report for the years 1995 through 1997 and after reviewing same, we would like to take this opportunity to respond because we do not believe that our responses to the Preliminary Reports 1 through 4 were taken into consideration when this Draft was compiled.

We would like to place the timing of this audit in the proper context and present some historical data that may be relevant. First of all, this present Board was not apprised that a Policy and Procedures Manual existed and needed to be updated. It is only within the last two years that this present board has heard the term and need for a "Policy and Procedures Manual." Except for one member, whose has served consecutive terms on the Board of Directors prior to 1991, all present members have only served from 1991 to as late as 1997.

Prior to 1991 a major change took place. Our past Managing Agent, Jerome Belson, who had been the managing agent since the inception of the corporation dumped all the financial records of HSH on the premises, and relinquished their responsibility for managing HSH. The board at that time hired an interim manager by the name of SHINDA and subsequently hired an agent by the name of E.T. Marshall.

During E.T. Marshall's tenure, with DHCR's approval boilers were installed during the winter months at tremendous hardship to the shareholders, both financially and through inconvenience. Although the corporation went through the necessary DHCR approval process, these boilers, are still today, a source of numerous complaints, lawsuits and financial burden to the housing. Because of improper and/or inadequate specifications and/or installation, banging noises exist, and there have been major water damage and mildew problems to at least 50% of the apartments, which have to be repaired. This board since 1991 has had to sort through documents to determine who is usually responsible for attending to our numerous boiler problems. We have not been very successful in getting much help from DHCR to resolve these problems.

Because of poor performance by E.T. Marshall, another Agent, Johnson and Pagan was hired on an interim basis. They subsequently became the Managing Agent from 1994 - 1997. Again, in February of 1997, because of DHCR's Field Representative Report showing poor performance in almost every category, and the Board's personal evaluation, the management contract was bided out and a new agent, ELM Management was selected.

In the recent past there was a perception by DHCR that the Board has developed a hostility to DHCR and has not complied with regulations. It may also be the perception of the Board of Directors that they have had to resolve many issues on their own and DHCR intervenes on shareholders' behalf only. Some members have also felt that the Board should exercise judgement in responding to shareholder complaints based on prior experience with the court system e.g. replacement of personal belongings because of water damage. The courts recently threatened the housing with a Class B Violation because of a shareholder's complaint as justification for not paying maintenance charges. The judgement mandated that the apartment be repaired immediately. This necessitated extensive lintel and pointing work to correct the situation.

Because of the DHCR representatives now assigned to HSH, the Board has been able to develop a spirit of cooperation with them and hopefully, some of the misconceptions will be dissolved and we can work towards making Harry Silver a viable and healthy corporation.

While the foregoing is not meant to excuse the Board from carrying out its fiduciary responsibilities, it must be understood in the proper context of the audit, which came at a time when the Board of Directors and its Managing Agent are still spending an exorbitant amount of time in resolving problems of the past i.e. mildew, banging noises in the pipes, court system etc. and therefore cannot designate the amount of time needed to correct some of the recommendations given in the Draft. The changes in Managing Agents mentioned above were made to try and select a knowledgeable Managing Agent who would be diligent in carrying out its responsibilities, and alleviate some of the mentioned problems. However, not much has been accomplished. The shareholders' files are still not updated and many issues still remain unresolved. The Board is unable to issue Stock Certificates and new Leases until the files are properly reviewed.

EXECUTIVE SUMMARY - Audit Observations (Paragraphs 1 through 3)

Board's Response: Records could not be located because the new agent was in transition. The Board Treasurer later submitted copies of many of the invoices, purchase orders and checks that were said to be missing, but were filed properly in the office. In its initial response to your Preliminary Report, the Board indicated that their wishes could not supersede the court system which was favorable towards tenants in L/T court, and therefore could not be held responsible for L/T cases that were being held up in the courts. Furthermore, the Board

has tried to select an Agent who would be proactive in the collection of maintenance charges, however, they have not fulfilled that obligation in the past nor present. The Board can only exercise due diligence by bidding out the management contract, until the right agent is selected, that would make a difference at HSH. It should be indicated in your comments that the scope of operations mentioned is from the inception of the corporation and not only 1995-1997.

EXPENDITURES - Page 4 (Paragraph 3)

Board's Response: Under RECORDKEEPING it states "what were reportedly personal copies of these records." the board feels that the underlined word has a malicious intent since it gives the impression that it is unusual for the Treasurer to keep copies of the Monthly Detailed Rent Reports, Receipts & Disbursement Report, Bank Reconciliations Reports etc. and that some subversive activity was taking place. Furthermore, the Treasurer's copies of the above were submitted prior to the completion of the audit. The only items submitted subsequent to the audit were taken from the Site Office (purchase orders, invoices, copies of checks etc.) because the Preliminary Report did not give details on what was missing, nor does the Treasurer recall the auditors requesting same from the Board of Directors.

*
Note

According your table of items that were either missing or lacked approval. 10 invoices and 6 checks were subsequently submitted and the table should reflect same, or another accurate table should be presented indicating the actual percentages of items missing or lacking approval. Regarding a transfer of funds in the amount of \$42,000 from the Operating A/C to the Escrow A/C, A-Lam Pest Control, Seavey Fingeret, Horizon Elevator, NYC Waterboard and Security Plus, we quote from the Board's Response dated February 16, 1998 to Preliminary Report #2 "A-Lam Pest Control, Seavey Fingeret, Horizon Elevator and Security Plus are contractual and do not require purchase orders. Transfer of Funds from Operating A/C to Escrow A/C is not usually accompanied by a purchase order"

*
Note

The check for \$13,627 dated 4/21/97 was payable to NYC Water, and it had been agreed that the Managing Agent would be allowed to sign utility bills to avoid late payments, therefore Board signature was not necessary. Also regarding the check for \$2,051.71 dated 2/23/95 payable to Village Hardware and check for \$1,026.75 dated 3/17/94, payable to J & B, these two companies are apparently subsidiary companies and share the same address. Due to a clerical mistake as per Jerry from Village Hardware "the wrong endorsement was placed on the checks and the mistake was not detected by the Bank." As far as HSH is concerned, the materials from J & B were received. It should

also be noted that it is the Controller's responsibility to cite and investigate errors such as this when they occur.

UNUSUAL EXPENDITURES - Page 6 (Paragraphs 2 and 3)

Board's Response: As indicated previously, because of the history of water damage to several apartments, the board took the position that it would be a waste of corporate funds and time to pursue this no win situation in the courts. Prior experiences have shown that the courts usually give favorable awards to tenants/shareholders. The Board feels that Real Property Law Regulations should be amended to be more flexible where the Board can make decisions in the best interest of the corporation, instead of having them resolved in the court system.

ACCOUNTS RECEIVABLE - Page 10 (Paragraph 1)

Board's Response: Although the scope of the audit is indicated as 1995-1997 for all intents and purposes, this paragraph compares the Arrears Report to 1992. We quote from the Board's Response to Preliminary Report #4 dated April 8, 1998 "A collection procedure has always been in place for shareholders in arrears, however, the housing has to depend on the court system to implement same. This is a very difficult task since the courts look very favorably on tenants/shareholders in arrears. Our former shareholder list has since been placed with a Collection Agency."

According to our records when the current Managing Agent assumed responsibility for the affairs of HSM in February 1997, the accuracy of the accounts receivable reconciled with the Treasurer's records.

- APARTMENT OCCUPANCY APPROVAL - Page 13
- RECORD PREPARATION - Pages 14 - 15
- POLICY AND PROCEDURES MANUAL - Page 16

It should be mentioned that this Section covers information from the inception of the Corporation and does not pertain only to years 1995-1997 and should be so indicated in the Final Audit Report. We quote from the Board's response dated April 8, 1998 to Preliminary Report #3.

Apartment Switching "Two shareholders switched apartments without permission from the Board of Directors, Management nor DHCR (see DHCR's letter attached requesting Board action to correct this situation.) This letter was sent to the Board of Directors when one of the shareholders in question requested an

*

Note

internal transfer to a two bedroom and DCHR records reflected that she already had a two bedroom apartment."
Missing Certificate Stub "28 of the stock certificates missing are for shareholders who moved in prior to 1991."
Executed Lease Agreement "11 of the files missing Lease Agreements are prior to 1991. The present board can only be held accountable for the 6 leases missing from 1991 to present."
Missing DCHR Occupancy Approval "14 of the files missing approval were prior to 1991. This present board is only accountable for 9 of those files stated as missing approvals. ELM Management will respond for any approvals missing from February '97 to present. We have been advised by the past Board President that approvals are kept in a separate file, since DCHR approves multiple applicants on one sheet."

In conclusion, please permit the Board of Directors to reiterate that their responses to Preliminary Audit Reports 1 through 4 have not been taken into consideration for the preparation of this Draft Report. It should also be noted, as stated at the beginning of the Board's Response to this Report, that all Board Members with one exception, hold 9-5 jobs and the exorbitant amount of time they have to spend in resolving problems of the past is ludicrous, especially since this audit was conducted while a new Agent was in transition and had not yet become accustomed to the site.

The Board understands that only individual shareholders were initially interviewed during this audit, and the Board of Directors were only requested to respond to allegations and findings when the Preliminary Audits were produced.

State Comptroller's Note

Certain matters addressed in the draft report were revised or deleted in the final report. Therefore, some agency comments included in Appendix B may relate to matters no longer contained in this report.