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# AUDIT REPORT



## CITY OF ITHACA COMMUNITY PLANNING AND DEVELOPMENT PROGRAMS

ITHACA, NEW YORK

2002-NY-1001

MARCH 21, 2002

OFFICE OF AUDIT  
NEW YORK/NEW JERSEY DISTRICT

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Issue Date

March 21, 2002

Audit Case Number

2002-NY-1001

TO: Michael F. Merrill, Director, Community Planning and Development Division, 2CD

*Alexander C. Malloy*

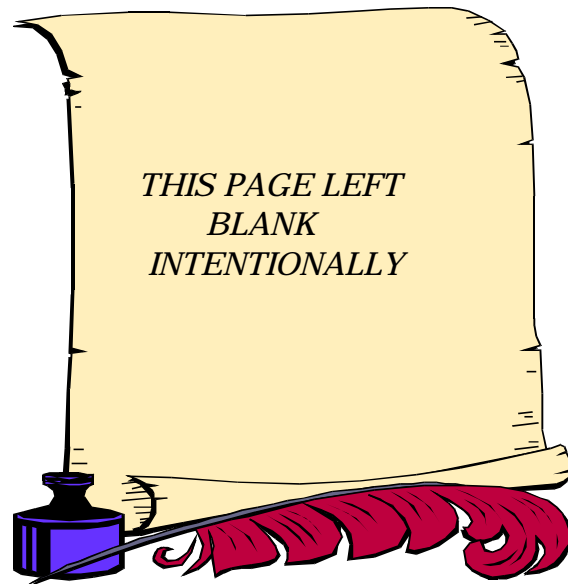
FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: City of Ithaca  
Community Planning and Development Programs  
Ithaca, New York

We examined the operations of the City of Ithaca, New York (Grantee) pertaining to its Community Planning and Development Programs. Specifically, we examined its Community Development Block Grant (CDBG) Small Cities program, Section 108 Loan and Grant Program, and Brownfield Economic Development Initiative (BEDI) Grant. The objectives of the audit were to determine if the Grantee carried out its U.S. Department of Housing and Urban Development (HUD) funded programs in an effective and efficient manner, and complied with applicable HUD requirements and Federal regulations. This report contains three findings with recommendations for corrective action.

Within 60 days, please furnish this office, for each recommendation cited in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any issued correspondence or directives related to the audit.

If you have any question, please contact Garry Clugston, Assistant District Inspector General for Audit, on (716) 551-5755, extension 5901.




# Executive Summary

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We examined the operations of the City of Ithaca's (Grantee) Community Planning and Development Programs. Specifically, we reviewed its CDBG Small Cities Program, Section 108 Loan and Grant Program and Brownfield Economic Development Initiative (BEDI) Grant. In addition, we reviewed the use of program income from completed Urban Development Action Grant (UDAG) and Housing Development Grant Program (HODAG) projects. The purpose of the examination was to determine whether the Grantee carried out activities as shown in its applications in an economical, efficient, and effective manner and complied with applicable requirements, laws and regulations that pertain to the Community Planning and Development Programs. The review covered the period from July 1, 1999, to December 31, 2000.

Our review disclosed that the Grantee generally complied with HUD program requirements when administering its Community Planning and Development Programs. However, our review disclosed that for certain areas the Grantee did not always carry out its activities in an efficient and effective manner, comply with the HUD regulations and charge costs to the Programs that are necessary and reasonable.

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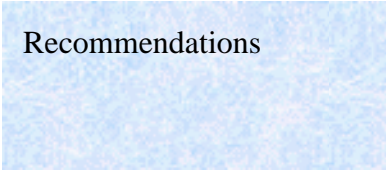
## Improprieties involving the Marina Realty Development Project

The Grantee did not implement adequate program controls to ensure that the Developer of the Marina Realty Development Project complied with HUD requirements and Federal regulations. Through various HUD loans and grants, the Grantee disbursed Federal funds to the Developer without adequate assurance that the funds were used to incur necessary and reasonable costs. Consequently, we found ineligible costs of \$76,486.25 that represent payments for duplicate withholding taxes, unnecessary interest cost, late fee charges, unnecessary environmental cost and for restaurant equipment that was not included in the grant agreement. We also found unsupported costs of \$196,811.08 that lacked adequate documentation for us to make an eligibility determination. We attribute the cause of these deficiencies to the Grantee's failure to place adequate emphasis on establishing procedures that required compliance with HUD regulations and ensured that costs incurred were adequately supported and for eligible activities.

Our review of the Grantee's management controls disclosed that the Grantee did not adequately monitor the activities and operations of a subrecipient. We believe that adequate monitoring was not performed due to the Grantee's general unfamiliarity with applicable program requirements. As a result, the Grantee could not demonstrate that CDBG funds

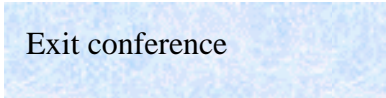
amounting to \$100,009 were used for activities allowed by program requirements.

Our review disclosed various non-compliances pertaining to accounting and administrative procedures that weakened the Grantee's system of management controls. These non-compliances occurred because procedures were not established to ensure that adequate financial and administrative controls were implemented to meet program requirements. As a result, the Grantee does not have adequate assurance that all activities of HUD funded programs are eligible and being properly administered. Consequently, we found costs, totaling \$207,916 that we consider questionable and/or unsupported.



Recommendations

We recommended actions that will strengthen the Grantee's future administration of HUD funded programs. Also, we recommended that you require the Grantee to repay the ineligible costs of \$76,486.25, and provide justification for the unsupported costs of \$504,736.08.



Exit conference

The results of the audit were discussed with Grantee officials during the course of the audit and at an exit conference held on February 7, 2002, at City Hall, Ithaca, New York. The Grantee's written response is shown in Appendix C. In addition, we have included a summary of the Grantee's comments after each finding.

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## Abbreviations

|       |   |
|-------|---|
| ACL   | Audit Command Language                            |
| BEDI  | Brownfield Economic Development Initiative        |
| CCI   | Canal Corridor Initiative                         |
| CDBG  | Community Development Block Grant                 |
| CFR   | Code of Federal Regulations                       |
| FY    | Fiscal Year                                       |
| HODAG | Housing Development Grant Program                 |
| HUD   | Department of Housing and Urban Development       |
| INHS  | Ithaca Neighborhood Housing Services              |
| OMB   | Office of Management and Budget                   |
| NYDEC | New York Department of Environmental Conservation |
| UDAG  | Urban Development Action Grant                    |

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# Introduction

Title I of the Housing and Community Development Act of 1974, established the Community Planning and Developments programs. These programs provide grants to States and units of local governments to aid in the development of viable urban communities. The Section 108 Loan Guarantee Program provides a means by allowing communities to finance up-front, certain large-scale projects.

The Grantee is governed by the Mayor, Alan J. Cohen, and the Common Council. The Grantee's office is located at City Hall, Ithaca, New York. The Ithaca Urban Renewal Agency administers the programs for the Grantee. The Executive Director is H. Matthys Van Cort.

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## Background

For Fiscal Years (FY) 1996 through 1999, the Grantee received Community Planning and Development funds amounting to \$6,119,000. Included in this amount was a Brownfield Economic Development Initiative Grant of \$350,000 regarding the Marina Realty Development project. The Grantee also administered a FY 97 Canal Corridor Initiative award of \$1,899,243.

During the audit, we reviewed seven activities that had total incurred cost of \$1,988,000, of which we examined \$1,328,000. In addition, we examined funds totaling \$1,287,947, used in support of the Marina Realty Development Project.

## Audit objectives

The audit objectives were to determine whether the Grantee: (1) carried out its activities as shown in its submissions to HUD in an economical, efficient and effective manner; (2) complied with applicable provisions of the Housing and Community Development Act of 1974 regarding the requirements, laws and regulations of the programs; and (3) has adequate controls to ensure compliance with HUD regulations.

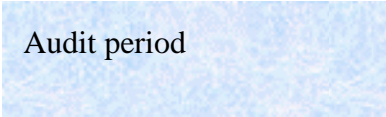
## Scope of review

To accomplish the audit objectives, the following audit procedures were performed:

- Examined records and files of the Grantee.
- Interviewed Grantee and HUD staff.



- Reviewed the Grantee's policies and procedures and observed its operations relating to the audit objectives.
- Used Audit Command Language (ACL) to select and analysis a sample of transactions from the Grantee's General Ledger. The sample consist of 30 transactions out of a total 1396.
- Reviewed and evaluated the Grantee's monitoring activities.
- Reviewed records and files of the Grantee's subrecipient, Ithaca Neighborhood Housing Services.



Audit period

We performed the audit field work from May 2001 through February 2002. The audit covered the period from July 1, 1999 to December 31, 2000. However, as necessary, we reviewed activity prior and subsequent to the audit period. The audit was conducted in accordance with generally accepted government audit standards.

A copy of this report was provided to the Grantee.

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## Improprieties Occurred Involving The Marina Realty Development Project

The Grantee did not implement adequate program controls to ensure that the Developer of the Marina Realty Development Project complied with HUD requirements and Federal regulations. Through various HUD loans and grants, the Grantee disbursed Federal funds to the Developer without adequate assurance that the funds were used to incur necessary and reasonable costs. Consequently, we found ineligible costs of \$76,486.25 that represent payments for duplicate withholding taxes, unnecessary interest cost, late fee charges, unnecessary environmental cost and for restaurant equipment that was not included in the grant agreement. We also found unsupported costs of \$196,811.08 that lacked adequate documentation for us to make an eligibility determination. We attribute the cause of these deficiencies to the Grantee's failure to place adequate emphasis on establishing procedures that required compliance with HUD regulations and ensured that costs incurred were for eligible activities.

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### Background

In March 1997, the Grantee applied to HUD for funding under the Canal Corridor Initiative (CCI). Part of HUD's approval included \$550,000 of Section 108 Loan authority for the Marina Realty Development Project. The total cost of this project was estimated to be \$1,900,000, of this amount the Developer was required to provide \$1,350,000 from private sources. In addition, as part of the CCI application, the Grantee requested \$350,000 of Section 108 Loan authority to be a Grant, so that the Grantee could make various public improvements in and around the marina area.

In August 1998, the Grantee applied to HUD for a \$350,000 Brownfield Economic Development Initiative (BEDI) Grant for the benefit of the Marina Realty Development Project. In the Grantee's BEDI application to HUD, the Grantee asked for an increase of its Section 108 Loan authority from \$550,000 to \$800,000.

In May 1999, the Grantee submitted a formal application to HUD, which HUD subsequently approved, increasing the Grantee's Section 108 Loan authority to \$800,000. Furthermore, the total estimated cost of the Marina Realty Development Project increased from \$1,900,000 to

\$2,100,000<sup>1</sup>. However, the funds expected to come from private sources decreased from \$1,350,000 to \$950,000.

During our review of the Marina Realty Development Project, we noted various deficiencies, which are discussed in the subsections that follow. To facilitate the resolution of this finding we have included pertinent information regarding ineligible and unsupported costs in Appendix B to this report.

#### Section 108 Loan

##### Criteria

OMB Circular A-87 provides that, to be allowable under a grant program, costs must be necessary and reasonable for proper and efficient administration of the program, and be adequately documented.

Ineligible costs of \$5,321.47 and unsupported costs of \$15,146.35

Our review of the \$800,000 Section 108 Loan disbursement records disclosed that the Developer made a duplicate payment of \$4,641.88, when it paid the quarterly withholding taxes. Also, our review disclosed that the Developer used \$679.59 to make interest payments pertaining to CDBG loans. We consider these payments totaling \$5,321.47 to be unnecessary and therefore, ineligible costs in accordance with Office of Management and Budget (OMB) Circular A- 87.

Also, we found that the Developer could not provide adequate documentation for costs totaling \$15,146.35. The costs consisted of: (a) payments for work and services that were not supported by billings or invoices, (b) payments to an identity of interest entity for services that are unsupported, and (c) payments for items with inconsistencies between dates and amounts on invoices and payment checks. Due to the lack of supporting documentation and the discrepancies in the information on available documents, we consider the \$15,146.35 to be unsupported cost.

#### BEDI Grant

Ineligible cost of \$21,164.78

HUD awards BEDI Grants to Grantees to clean up and redevelop environmentally contaminated industrial and commercial sites (brownfields). Our review disclosed that

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<sup>1</sup> The Grantee initially estimated the project to cost \$2,100,000 of which the Developer would provide \$1,600,000 from private investments and request a \$500,000 Section 108 Loan.

the Grantee disbursed BEDI Grant funds for unnecessary costs that did not pertain to the site remediation. In addition, the Grantee used BEDI Grant funds to pay for fines and late payment penalties. Use of Grant fund for these type of costs are not allowed by OMB Circular A- 87, Attachment A,C.1.a and Attachment B, Section 20 As a result, the Grantee expended \$21,164.78 of BEDI Grant funds for ineligible costs ( \$13,496.05 plus \$7,668.73).

Unsupported costs  
\$31,664.73

In addition, the Grantee disbursed \$31,664.73, of BEDI Grant funds for questionable activities. For example, \$24,619.91, of Grant funds was used to pay interest costs on loans provided by principals of the Developer. Also, \$7,044.82 was used to pay for costs incurred prior to HUD's approval of the BEDI Grant application and/or lacked adequate supporting documentation. We questioned whether the costs were necessary expenditures; thus, we consider BEDI costs of \$31,664.73 as unsupported costs pursuant to OMB Circular A- 87.

#### CDBG Loans

Unsupported costs  
\$150,000

The Grantee provided the Developer low interest CDBG loans of \$50,000 and \$100,000 on March 13, 2000, and March 14, 2000, respectively, to assist the Developer with project cost overruns. According to the HUD approved Section 108 Loan application, project overruns were to be the responsibility of the Developer. Moreover, according to the Grantee's Section 108 Loan application, the Developer was to provide \$400,000 of equity, which was to be injected in the project on a pro rata basis with the funding provided by HUD. The Grantee provided two CDBG loans to the Developer even though the Developer was not complying with the equity investment requirement. Furthermore, the Grantee did not inform HUD that the proceeds from the CDBG loans would be used for project overruns. Since the Section 108 Loan application provides that the Developer was responsible for any project costs overruns, we consider the proceeds from the two CBDG loans, amounting to \$150,000, that were applied to the project's cost overruns to be unsupported costs.

Section 108 Grant

In the Grantee's CCI application, the Grantee requested \$350,000 of Section 108 Loan authority to be a Grant, so that the Grantee could make various public improvements in and around the marina area.

Ineligible costs  
\$50,000

Our review disclosed that the Grantee used \$50,000, of Section 108 Grant funds to reimburse the Developer for the purchase of restaurant equipment. The payment of \$50,000 to the Developer was clearly not part of the approved Section 108 Grant application. Thus, we consider the \$50,000, used to reimburse the developer for restaurant equipment to be an ineligible use of Section 108 Grant funds.

We attribute the cause of the aforementioned deficiencies to the Grantee's failure to place adequate emphasis on establishing procedures to ensure compliance with HUD requirements. Unless controls are implemented to ensure compliance with the program regulations, the deficiencies cited in this finding may continue to recur, and HUD funds may continue to be used in an inefficient and ineffective manner.

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Auditee comments

The Grantee agrees with some of the issues raised in the finding and disagrees with others, as follows:

Section 108 Loan

The Grantee indicated that it obtained documentation for some of the unsupported costs and proposes to substitute eligible documented costs that were not previously submitted by the Developer to offset the disputed ineligible and unsupported costs.

BEDI Grant

The Grantee indicated that given the BEDI requirements that the grant funds be drawn down on a pro-rata basis, the Developer had to finance the up-front costs of remediation. The Grantee believes that the interest payments to identity of interest entities are reasonable and necessary project cost. Furthermore, the Grantee states that the interest charged by the site remediation contractor is another form

of a necessary and eligible interest cost. Also, the Grantee stated that the payment for costs incurred after receipt of the New York Department of Environmental Conservation (NYDEC) certification was eligible and necessary to complete the remediation. The Grantee stated that the payment for environmental soil testing done prior to the BEDI Grant application was eligible based on HUD's authorization of payments for costs incurred prior to the Grant approval.

#### CDBG Loans

The Grantee provided in its comments that the Developer was responsible for reasonable cost overruns, but that the scope of the overruns of \$1.1 million was far above a normal or expected range of cost overrun, and due to the fact that the project faced a very real prospect of failing. The Grantee stated that the two CDBG loans require repayment by the Developer.

#### Section 108 Grant

The Grantee stated that the \$50,000, provided to the Developer was to implement components of the waterfront promenade trail and allow public access to the Developer's parking area. The Grantee believes that this was an efficient use of Grant funds to gain valuable public access and convenient trailhead parking that are necessary for the success of the promenade trail.

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#### OIG evaluation of auditee comments

Concerning the Grantee's response regarding ineligible and unsupported Section 108 Loan costs, the HUD Field Office needs to determine if the substitution of other eligible costs is acceptable.

Regarding the BEDI Grant, we believe that the interest payments to the identity of interest entity are simply not necessary and reasonable costs. The \$13,496.05 charge by the contractor could have been avoided, if the Developer had promptly paid the contractor. Also, since the NYDEC letter of June 11, 1999, indicated that the remediation was complete, cost incurred after that date are not eligible

charges to the BEDI Grant. Concerning the costs incurred prior to the BEDI Grant application, the Grantee's letter to HUD requested approval of pre-award costs to be incurred in late February, 1999; however, the cost that we are questioning, was paid on July 23, 1997, prior to the submission date of the BEDI application to HUD.

The addition of the CDBG loans funds changed the amount of Federal assistance to the project and the dollars per job ratio of the project. The HUD Field Office needs to make a determination as to the eligibility of the use of the CDBG loan funds to pay for project cost overruns.

The supporting documentation for the \$50,000, Section 108 Grant indicates that it was used for restaurant (kitchen) equipment not public improvements. As a result, we consider the cost to be an ineligible use of Section 108 Grant funds.

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## Recommendations

We recommend that you:

1A. Determine the eligibility of the \$196,811.08 of unsupported cost discussed in this finding.

Also, we recommend that you instruct the Grantee to:

1B Reimburse the applicable program the amount of the ineligible costs of \$76,486.25 from non-Federal funds and to seek reimbursement from the Developer.

1C. Reimburse the amount of any unsupported costs determined to be ineligible from non-Federal funds.

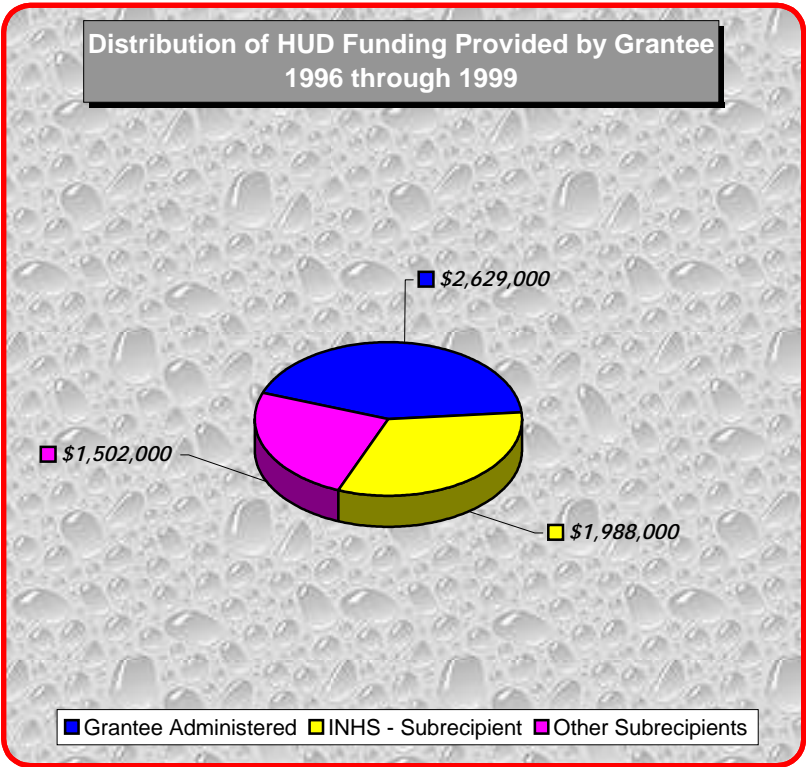
1D. Instruct the Grantee to implement procedures to ensure that all development activities comply with Federal regulations and program requirements.

# Inadequate Monitoring Of The Ithaca Neighborhood Housing Services

Our review of the Grantee’s management controls disclosed that the Grantee did not adequately monitor the activities and operations of a subrecipient, the Ithaca Neighborhood Housing Services (INHS). We believe that adequate monitoring was not performed due to the Grantee’s general unfamiliarity with applicable program requirements. As a result, the Grantee could not demonstrate that CDBG funds, amounting to \$100,009, were used for activities allowed by program requirements.

## Background

During the audit period the Grantee awarded its subrecipients more than half of its program funding, the majority of which was provided to a single subrecipient, INHS. We examined the program files for seven activities administered by INHS, representing \$1,328,000 of the \$1,988,000 of CDBG funds provided by the Grantee to INHS during the period 1996 through 1999. The activities administered by INHS included housing improvement and home ownership opportunities for low to moderate income persons.





The purpose of our review was to evaluate the Grantee's management controls and monitoring efforts regarding the administration of its HUD funded activities. Specifically, we sought to determine if the Grantee and its subrecipient, INHS: complied with CDBG requirements; incurred only costs that were necessary and reasonable; and, successfully administered activities that resulted in program objectives being achieved.

Criteria

Title 24, Code of Federal Regulations (CFR) Part 85 contains the requirements that grantees are to follow regarding program monitoring, including the activities administered by subrecipients. In addition, Part 85 provides financial management standards that must be met by the grantee and subrecipients. Finally, Title 24, CFR Part 570.501 provides that the grantee is responsible for determining the adequacy of performance under subrecipient agreements.

Contrary to the requirements, the Grantee did not effectively administer or monitor activities managed by INHS. Among other things, our review disclosed that a formal monitoring policy had not been implemented and the Grantee had not performed on site monitoring of INHS's activities. Details pertaining to some of the weaknesses identified are described in greater detail below:

Inadequate support for program costs

Grantee provided funds without adequate supporting documentation

Agreements executed between the Grantee and the INHS provided for program funds to be disbursed based on receipt of a request for payment specifying the costs incurred and receipt of appropriate supporting documentation. Contrary to this requirement, our review of the program files disclosed that the Grantee routinely provided program funds to the INHS without obtaining sufficient documentation. Consequently, several instances were found where funds were disbursed prior to the work being completed. In one instance, funds were disbursed to the INHS nearly fifteen months prior to the work being completed.

Six of the seven agreements that we reviewed provided that the INHS would receive a program delivery fee for its housing rehabilitation and home ownership activities.

Payments for such fees were to be documented by timesheets, invoice, or other appropriate information to evidence the costs associated with the rehabilitation and home ownership activities. Our examination of the program files revealed that the Grantee paid INHS the program delivery fees without any supporting documentation to justify the payments. Because there was no documentation to determine the eligibility of the costs charged as program delivery fees, we consider the entire amount charged under the six agreements, amounting to \$77,352 as unsupported costs.

#### Inadequate reporting of program objectives

Subrecipient performance reports inadequate

Title 24, CFR Part 570.503 provides, in part, that the grantee is responsible for assuring that subrecipients submit performance reports regarding their activities. We found that the reports submitted by INHS were not always of sufficient detail to determine if HUD program objectives were being met. Moreover, we noted instances where inaccurate information provided by INHS was included on the performance reports submitted to HUD.

#### Rehabilitation work not supported

Rehabilitation work not supported

In addition to our review of the program files maintained by the Grantee, we examined the project files for a housing rehabilitation activity managed by INHS. We found that for the most part the rehabilitation work and associated costs were adequately supported. However, our review disclosed instances where:

- there was no evidence that an initial and/or final inspection of the property to be rehabilitated had been performed; and
- there was no evidence of final approval of the construction work by the homeowner.

Supporting documentation not in file

We also noted an instance where the project file did not contain supporting documentation for the rehabilitation costs pertaining to one property. The INHS received a total of \$22,657 for the rehabilitation of this property; however, there was no evidence that the work had been done. Due to the lack of documentation to support that the rehabilitation

work had been performed, we consider the \$22,657 as unsupported costs.

The weaknesses described above underscore the need for improvements in the Grantee's monitoring of its HUD programs. Unless corrective actions are implemented, the Grantee will not have adequate assurance that the INHS is complying with program regulations.

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Auditee comments

The Grantee concurred that program delivery fees paid to INHS for the seven activities audited were not properly documented. However, the Grantee believes that the delivery fees were reasonable and necessary because of program achievements. Also, the Grantee provided that corrective action has already instituted.

In its response, the Grantee stated that prior to this audit finding, its staff discovered that \$22,657 of CDBG funds were mistakenly paid to the subrecipient in advance of rehabilitation work being completed. The Grantee indicated that it requested and received a rebate of the over paid funds from the subrecipient and that the subrecipient has submitted documentation that the rehabilitation work in question has been satisfactorily performed, including final approval of the construction work by the homeowner.

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OIG evaluation of auditee comments

The statement that the Grantee believes that the program delivery costs were reasonable or necessary, does not alter the fact that the subrecipient has not provided documentation to support the program costs. The lack of supporting documentation and adequate monitoring of the subrecipients activities seriously weakens the Grantee controls over the use of the CDBG funds.

The Grantee states that a rebate of the over payment of \$22,657, and final approval of the construction work by the homeowner has been received. However, the Grantee did not provide any evidence to support these facts.

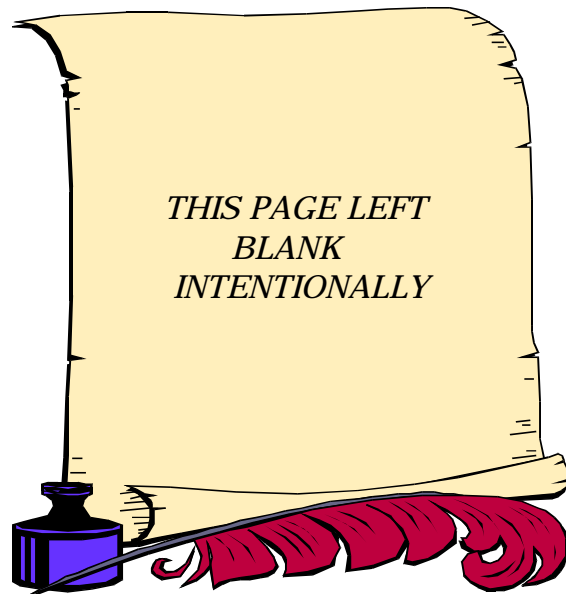
Recommendations

We recommend that you:

- 2A. Determine the eligibility of the unsupported costs of \$77,352 pertaining to the program delivery fees and the \$22,657 associated with the rehabilitation work.

Also, we recommend that you instruct the Grantee to:

- 2B reimburse the programs from non-Federal funds for any amount determined to be unsupported.
- 2C. Implement corrective actions that will ensure compliance with program regulations regarding monitoring the performance of program activities.



## Unsupported Use Of Program Funds And Management Control Weaknesses

Our review disclosed various non-compliances pertaining to accounting and administrative procedures that weakened the Grantee's system of management controls. These non-compliances occurred because procedures were not established to ensure that adequate financial and administrative controls were implemented to meet program requirements. As a result, the Grantee does not have adequate assurance that all activities of the Community Planning and Development Programs are eligible and being properly administered. Consequently, we found costs, totaling \$207,916 that we consider unsupported.

### Criteria

OMB Circular A-87, Cost Principles for State and Local Governments provides that grantees are responsible for the efficient and effective administration of grant programs through sound management practices. In addition, Title 24, CFR, Part 85.40 provides that grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities to ensure compliance with applicable Federal requirements.

### Scope

We selected a random sample of transactions from the Grantee's financial data files using Audit Command Language (ACL) software. Also, as part of our survey work we examined the Grantee's general ledger activity report for the operating cash account. Based on our survey work we selected a sample of transactions to review. The review examined the documentation supporting the costs related to the transactions, and the allowability and reasonableness of the expenditures.

The following items should not be considered all-inclusive; rather, they represent only those non-compliances found as a result of our review.

#### Accounting and administrative deficiencies

- A. Questionable Use of Urban Development Action Grant (UDAG) Program Income funds

UDAG program income used to pay settlement claim

The Grantee authorized the expenditure of \$57,000 of UDAG program income to settle a notice of claim filed by a former employee. A Stipulation and Agreement was executed between the parties to resolve the matter and settle the notice of claim without litigation or administrative proceedings. The Agreement provided for payment to the former employee in the amount of \$54,367.32 representing one year's salary, payroll taxes, and the sum of \$2,032.26 as an allowance towards the purchase of a chair and a computer. In addition, the Grantee agreed to pay the former employee's health insurance premiums for a period of one year, not to exceed a total cost of \$2,632.68. The Grantee used \$57,000 of UDAG program income to make the abovementioned payments.

Criteria

OMB Circular A-87 establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments. Attachment A of the Circular provides that Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices and that costs charged be necessary and reasonable for the proper and efficient performance and administration of federal awards. Attachment B of the Circular provides that fines, penalties, damages, and other settlements resulting from violations (or alleged violations) or failure of the governmental unit to comply with Federal, State, or local laws and regulations are unallowable. Moreover, Exhibit A of the UDAG grant agreement provides that program income and/or miscellaneous revenues received shall be spent for activities eligible under Title I of the Housing and Community Development Act of 1974, as amended.

Questionable use of \$57,000 of UDAG program income

We question whether the Grantee's use of UDAG program income to settle a claimed filed by a former employee represents an eligible activity under Title I of the Housing and Community Development Act. Accordingly, we consider the \$57,000 used to settle a former employee's claim against the Grantee to be a questionable use of program income of the UDAG program.

## B. Unsupported Costs

Adequate controls have not been implemented to ensure that program income of the Housing Development Grant Program (HODAG) is used in accordance with program requirements. Our review disclosed that for the Grantee's Fiscal Years 1999 and 2000, HODAG program income, totaling \$130,000 (\$65,000 per fiscal year) were used for costs that were not adequately supported. Our review disclosed that the Grantee provided \$65,000 per fiscal year to the Ithaca Neighborhood Housing Services (INHS). The Grantee could not provide any documentation as to how INHS used the HODAG program's funds. Accordingly, we consider the \$130,000 as unsupported costs.

### Criteria

The HODAG grant agreement provides, in part, that program income shall be treated as miscellaneous revenue, and shall be used by the Grantee to support the construction, rehabilitation or operation of real property to be used primarily for low and moderate income residential rental purposes. In addition, OMB Circular A-87 provides that, to be allowable under a grant program, costs must be necessary and reasonable for proper and efficient administration of the program, and be adequately documented.

## C. Unsupported Payments to Contractor

### Payments to contractor lack adequate documentation

The Grantee did not adequately support payments made to an independent contractor. A comparison of the contractor's billing records with the services included in the contract showed that they generally did not contain adequate descriptions identifying the services performed. Title 24, CFR Part 85.20(b)(6) provides that accounting records must be supported by source documentation. Accordingly, we consider \$20,916 as unsupported costs.

## D. Inadequate Segregation of Duties

### Lack of segregation of duties

Various weaknesses were noted that illustrate an inadequate segregation of duties among employees. They include:

- Grantee receipts, such as lease payments, are received by the same individual that prepares the deposit slip and takes the receipts to the bank.



- The Grantee's fee accountant prepares checks and reconciles the bank accounts.
- An individual with authority to draw down grant funds is also authorized to sign checks.
- The Grantee's procedures do not ensure that different employees are responsible for purchasing and voucher approval. On occasion, the same individual initiated the purchase and approved it.

E. Weakness in Controls Over Safeguarding of Assets

Assets not properly safeguarded

In addition, we noted weaknesses in the Grantee's controls over safeguarding assets. They include:

- Vouchers are not cancelled; and checks are cross-referenced to Request For Payment documentation instead of the actual invoices paid.
- The Grantee does not ensure that unissued checks are kept in a secure area. Instead, the Grantee forwards the check orders from the printer directly to the fee accountant. Moreover, at the time of our review, Grantee officials were unsure whether checks ordered are pre-numbered or pre-printed.
- According to the Grantee, two signatures are required on all checks. However, the printed checks do not indicate that two signatures are needed. Therefore, it is possible that a check with only one signature could be issued and cashed by a recipient.

The above deficiencies have reduced the Grantee's ability to establish a reliable system to evaluate its overall program performance. Unless corrective actions are implemented, the control and accountability over program funds could be adversely affected.

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**Auditee Comments**

The Grantee provided comments on the following items in the finding:

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### Settlement Claim

In its response, the Grantee provided that in its view the Grantee was protecting the Federal financial interest and the best interests of the CDBG program when it settled the notice of claim without litigation. The Grantee believed that this use of UDAG program income was consistent with the Act's primary objective and specifically, that the activity is an authorized eligible activity under Section 105(a)(12), and Section 105(a)(13).

### HODAG program income funds

The Grantee's response provides that the City erred in its agreements with INHS by not specifying that use of HODAG funds must be in accordance with program requirements.

### Unsupported Payments to Contractor

To address the finding, the Grantee said that the standard contract has been modified and the independent contractor is now attaching further documentation to its timesheet identifying what specific services were performed.

### Inadequate Segregation of Duties and Assets Not Properly Safeguarded

In its comments, the Grantee agrees to adopt policies and institute procedures to further segregate duties to the extent practicable given the small size of the staff. Also, the Grantee agrees to adopt all controls recommended in the audit to assure that assets are adequately safeguarded.

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### OIG evaluation of auditee comments

Regarding the Grantee response, OMB Circular A-87, Attachment B, Section 20, clearly provides that the payment of settlements resulting from violations (or alleged violations) or failure of the governmental unit to comply with Federal, State, or local laws and regulations are unallowable.

Recommendations

We recommend that you:

- 3A. Determine the eligibility of the unsupported costs of \$57,000 pertaining to the settlement claim, the \$130,000 of HODAG program income funds and \$20,916 in payments to a contractor.

Also, we recommend that you instruct the Grantee to:

- 3B. Reimburse the applicable programs for any of unsupported costs found to be ineligible.
- 3C. Establish procedures to ensure that all contract services are adequately identified prior to payment.
- 3D. Establish procedures to provide for an adequate separation of duties for those individuals who maintain control over cash.
- 3E. Adopt controls to ensure that assets are adequately safeguarded.

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# Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure its goals are met. Management controls include the processes for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting and monitoring program performance.

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## Relevant management controls

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

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

We assessed the relevant control identified above.

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

## Significant weaknesses

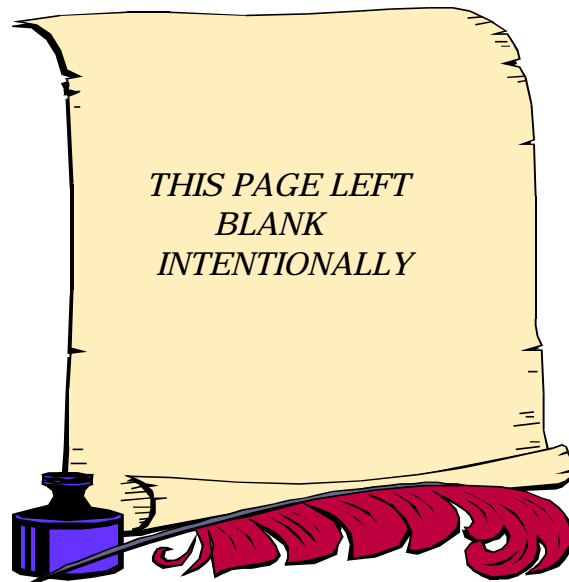
Based on our review, we believe that significant weaknesses exists in the following management controls. These weaknesses are described in the findings section of this report.

- The Grantee did not implement adequate program controls to ensure that the Developer of the Marina Realty Development Project complied with HUD regulations. Finding 1 (Program Operations) (Compliance with Laws and Regulations).
- The Grantee did not properly monitor its subrecipient activities. Finding 2 (Program Operations).
- The Grantee did not maintain adequate supporting documentation for costs. Finding 1, 2 and 3 (Validity and Reliability of Data).
- The Grantee did not have adequate controls to ensure that costs were eligible and properly supported. Finding 1, 2 and 3 (Validity and Reliability of Data), (Safeguarding Resources).

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# Follow Up On Prior Audits

An audit of the Grantee was performed by an Independent Auditor for the period ended December 31, 1999. The report did not contain any audit findings.

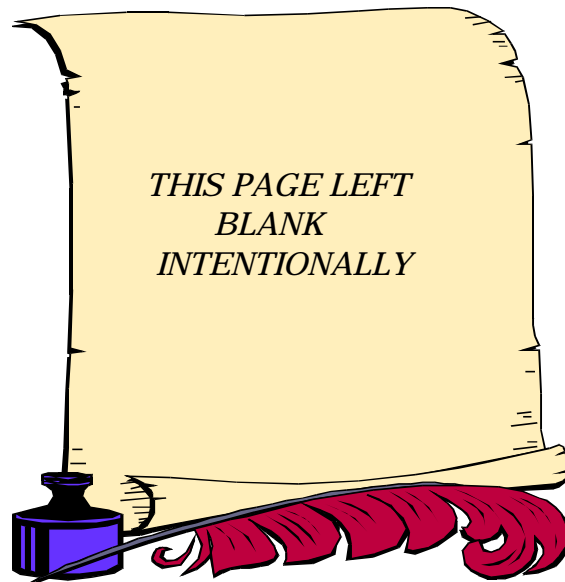


## Schedule Of Ineligible And Unsupported Costs

| <b>Finding Number</b> | <b><u>Ineligible</u><br/>(1)</b> | <b><u>Unsupported</u><br/>(2)</b> |
|-----------------------|----------------------------------|-----------------------------------|
| 1                     | \$76,486.25                      | \$196,811.08                      |
| 2                     |                                  | \$100,009.00                      |
| 3                     |                                  | \$207,916.00                      |
| <b>Total</b>          | <b>\$76,486.25</b>               | <b>\$504,736.08</b>               |

- (1) Ineligible costs are costs charged to a HUD financed or insured program or activity that the auditor believe are not allowable by law, contract, or Federal, State, or local policies or regulations.
- (2) Unsupported costs are costs charged to a HUD financed or insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the cost. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.





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**Schedule Of Ineligible And Unsupported Marina Realty Development Costs**

| Check<br>Date                          | Number | Payee/Description             | Ineligible  | Unsupported  | Foot<br>Note |
|--|--------|-------------------------------|-------------|--------------|--------------|
| <b>Section 108 Loan</b>                |        |                               |             |              |              |
| 1/23/99                                | 1065   | Accelerated Info & Doc Filing |             | \$20.00      | 1            |
| 3/1/99                                 | 1078   | Accelerated Info & Doc Filing |             | \$37.00      | 1            |
|  | N/A    | 1272 Miller & Flash           |             | \$3,000.00   | 2            |
| 11/18/99                               | 1273   | Miller & Flash                |             | \$200.00     | 2            |
| 3/27/00                                | 1361   | Data Flow                     |             | \$47.69      | 1            |
| 3/31/00                                | 1366   | Ithaca Urban Renewal Agency   | \$554.59    |              | 3            |
| 4/3/00                                 | 1368   | Ithaca Urban Renewal Agency   | \$125.00    |              | 3            |
| 4/4/00                                 | 1369   | Data Flow                     |             | \$22.74      | 1            |
| 4/13/00                                | 1384   | Public Abstract               |             | \$80.00      | 4,5          |
| 4/20/00                                | 1394   | Richard Ruswick               |             | \$148.50     | 6            |
| 4/20/00                                | 1393   | Accelerated Info & Doe Filing |             | \$113.00     | 1            |
| 5/3/00                                 | 1405   | Miller & Flash                |             | \$1,397.45   | 2,5          |
| 5/11/00                                | 1417   | Mariette Geldenhuys           |             | \$24.86      | 8            |
| 5/26/00                                | 1424   | Data Flow                     |             | \$233.28     | 7,4          |
| 6/15/00                                | 1448   | Mariette Geldenhuys           |             | \$29.33      | 7            |
| 7/7/00                                 | 1475   | Sciarabba Walker & Company    |             | \$4,040.00   | 7            |
| 7/18/00                                | 1491   | Kristin Baker                 |             | \$486.00     | 1            |
| 7/28/00                                | 1507   | Chris Purdy                   |             | \$1,004.30   | 2            |
| 8/7/00                                 | 1526   | Sciarabba Walker & Company    |             | \$1,645.00   | 7            |
| 8/16/00                                | 1538   | 1st Cardinal Corp             |             | \$1,000.00   | 7            |
| 10/10/00                               | 1592   | Gish Logging                  |             | \$1,310.00   | 1            |
| 10/10/00                               | 1591   | Ithaca Journal                |             | \$307.20     | 1            |
|  | N/A    | N/A IRS/TCTC Fed Withholding  | \$4,641.88  |              | 8            |
| Subtotal for Section 108 Loan          |        |                               | \$5,321.47  | \$15,146.35  |              |
| <b>BEDI Grant</b>                      |        |                               |             |              |              |
| 7/23/97                                | 1569   | GAI                           |             | \$6,763.50   | 9            |
| 7/1/99                                 | 1165   | Patricia Purdy                |             | \$281.32     | 7            |
| 8/16/00                                | 1542   | Patty Purdy                   |             | \$10,826.82  | 10           |
| 8/16/00                                | 1543   | Stephen B. Flash              |             | \$12,806.99  | 10           |
| 8/29/00                                | 1561   | Iacovelli Bros.               | \$13,496.05 |              | 11           |
|  | N/A    | N/A Paolangeli Contractor     | \$7,668.73  |              | 12           |
|  | N/A    | N/A Chris Purdy               |             | \$986.10     | 10           |
| Subtotal for BEDI Grant                |        |                               | \$21,164.78 | \$31,664.73  |              |
| <b>CDBG Funds</b>                      |        |                               |             |              |              |
| 3/9/00                                 | 11005  | Steve Flash/Marina Realty     |             | \$50,000.00  | 13           |
| 3/14/00                                | 11019  | Marina Realty of Ithaca, LLC  |             | \$100,000.00 | 13           |
| Subtotal for CDBG Loans                |        |                               |             | \$150,000.00 |              |
| <b>Section 108 Grant</b>               |        |                               |             |              |              |
| 3/8/01                                 | 11385  | Marina Realty of Ithaca, LLC  | \$50,000.00 |              | 14           |
| Subtotal for Section 108 Grant         |        |                               | \$50,000.00 |              |              |
| Total Ineligible and Unsupported costs |        |                               | \$76,486.25 | \$196,811.08 |              |

Footnotes

- 1 No evidence that cost is related to the project. OMB Circular A-87, Attachment A, C.1.h
- 2 Payment to identity of interest entity for services or costs that are unsupported and/or unreasonable. OMB Circular A-87, Attachment A, Section C.1.a
- 3 Cost for interest payment on the CDBG loans are ineligible. Title 24, CFR 570.703
- 4 Check dated prior to Invoice. OMB Circular A-87, Attachment A, C.1.h
- 5 Check amount does not agree with invoice(s). OMB Circular A-87, Attachment A, C.1.a
- 6 Payment for services that are not supported. OMB Circular A-87, Attachment A, C.1.j
- 7 Inadequate supporting documentation. OMB Circular A-87, Attachment A,C.1.j
- 8 Represents a duplicative charge for amount that was paid on 10/16/00, check no. 1603. Thus, the cost is ineligible. OMB Circular A-87, Attachment A, C.1.a
- 9 Represents costs incurred prior to the date of the BEDI application. OMB Circular A-87, Attachment A, C.1.a
- 10 Payments to identity of interest entity for interest costs that may not be a necessary or reasonable project cost. OMB Circular A-87, Attachment A, C.1.a
- 11 Costs do not pertain to site remediation, costs incurred after Certification. OMB Circular A-87, Attachment A, C.1.a
- 12 Service Charges or late payment fees not necessary and reasonable for Grant Administration. OMB Circular A-87, Attachment B, Section 20
- 13 Represents CDBG funds used for cost overruns. Budget overruns are the responsibility of the Developer in accordance with the Section 108 award.
- 14 An invoice for restaurant (kitchen) equipment supported the costs. The Section 108 Grant funds were to be used for public improvements. Thus, the cost is ineligible.

# Grantee Comments



CITY OF ITHACA  
108 East Green Street Ithaca, New York 14850-5690

OFFICE OF THE MAYOR • ALAN J. COHEN  
Telephone: 607/274-6501 Fax: 607/274-6526

February 11, 2002

Mr. Alexander C. Malloy  
District Inspector General for Audit  
Office of Inspector General  
U.S. Department of Housing and Urban Development  
Lafayette Court Building  
465 Main Street  
Buffalo, NY 14203-1780

Re: Grantee's Response to Draft Audit Findings  
City of Ithaca's Small Cities Community Development Block Grant Program

Dear Mr. Malloy:

Our goal is to use the audit as a learning tool to improve our efforts to utilize HUD funds in an efficient and effective manner to address community development needs. Thank you for the opportunity to provide the following comments on the draft audit findings:

1 Finding 1 - Canal Corridor Initiative

To establish the context for the Marina Realty of Ithaca, LLC (MRI) project, it is important to highlight the following two points:

1. The MRI project was an extremely complicated public/private project that successfully overcame a series of feasibility obstacles to achieve the principal program objectives to revitalize the underutilized commercial waterfront by converting a brownfield site into a vital restaurant/marina destination that employs 88 FTE jobs and generates substantial tax revenues.
2. The project sustained extraordinary cost overruns and encountered extensive delays that were beyond the control of the Developer and the grantee. The Developer pledged private investment of \$1.75 million dollars in the Section 108 loan application (excluding BEDI). A statement summarizing project expenses, provided by MRI's fee accountant, indicates that MRI ultimately invested over \$2.8 million dollars (excluding BEDI) in the project by the time the restaurant opened on 1/31/01. To further

document project costs, the grantee has requested the Developer to provide a detailed listing of project expenses.

**Section 108 Loan**

Unsupported Section 108 Loan Costs

Of the \$800,000 disbursed through the Section 108 loan, the draft audit identified \$5,321.47 as ineligible costs and \$15,146.35 of costs lacking adequate supporting documentation. We do not dispute the items categorized as ineligible expenses. Given the project’s large cost overruns, we propose to substitute eligible documented costs that were not previously submitted by the developer to offset the disputed ineligible costs.

For the unsupported costs, the largest single expense item was an \$4,040.00 payment to Sciarabba Walker & Company, Inc., MRI’s fee accountant. We agree that original cost documentation was inadequate in the form of a one-page summary statement covering five previous invoices and lacking a full description of the services rendered. MRI has now submitted the individual invoices to substantiate the expense, which if acceptable, will reduce the unsupported costs to \$11,106.35.

The grantee is working closely with the Developer to resolve the other unsupported costs items identified by seeking additional supporting documentation for each cost item. This additional cost documentation is anticipated to be available by the time the audit is finalized.

In addition to providing further documentation for the listed unsupported costs, we propose to submit additional eligible documented project costs that were not previously submitted by the developer for reimbursement as a means to ensure there are at least \$800,000 of supported Section 108 loan costs.

Based on the above, the total amount of ineligible and unsupported costs to date is \$16,427.82. Following are proposed additional Section 108 loan costs submitted by the Developer.

| <u>check date</u> | <u>check number</u> | <u>Payee/Description</u>                          | <u>Amount</u>     |
|-------------------|---------------------|---|-------------------|
| 11/16/00          | 1635                | Ellsworth Engineers/ HVAC & Plumbing Design       | \$1,769.30        |
| 12/4/00           | 1642                | Sign-A-Rama/ 2 neon signs                         | \$7,000.00        |
| 12/5/00           | 1650                | J.C. Watt Distributing/ beer draft equip.         | \$4,602.11        |
| 12/5/00           | 1654                | EFD of Ithaca, Inc./ logo, letterhead, stationary | \$1,534.00        |
| 12/5/00           | 1651                | Univera Healthcare/pre-opening health insur.      | <u>\$2,190.99</u> |
|                   |                     |   | \$17,096.40       |

In addition to the costs listed above, the Developer has submitted extra documented project costs.

To prevent unsupported costs from occurring in the future, the grantee proposes to institute the following enhanced procedures and heightened criteria for approving project cost submittals to ensure that project cost files contain adequate supporting documentation that each cost is necessary and reasonable:

1. require that each submitted cost is supported by a written invoice or bill that clearly indicates the services or goods purchased are related to the project and itemize out the services/goods provided;
2. continue grantee's policy of requiring submission of a copy of the front and back of the cashed check as proof of payment of project costs, where applicable;
3. apply heightened scrutiny for adequacy of supporting documentation and reasonableness of costs paid to any identity of interest entity; and
4. require borrower to submit cost documentation in a manner that summarizes and organizes cost submissions by category of authorized use of funds consistent with the project's approved budget. In addition, the summary submission of costs must identify the check date, check number, vendor and payment amount.

#### \$90,000 of Section 108 Funds Not Used for Purchase of Land

For reasons beyond the control of the Developer and the grantee, this property targeted for acquisition and renovation was unavailable for purchase when the Section 108 funds became available. The property remains in ownership by New York State and is administered by NYDEC. The grantee remains in negotiations to date with NYDEC to gain ownership of the property, and the Developer indicates strong interest in acquisition when the property becomes available.

Section 108 loan funds originally earmarked for property acquisition were used for non-construction cost overruns of the restaurant/marina project to ensure that primary job creation and revitalization objectives were accomplished. The grantee believed it had authority to redirect the Developer's use of loan funds from property acquisition to other eligible project costs to reflect the unavailability of the property for acquisition and under-estimates of project costs.

At the time that the Section 108 Loan application was developed, the property's administrator, NYDEC, indicated they were supportive of sale of the property directly to the Developer. The Developer planned to acquire the site, remove a portion of the building extending into the permanent flood control easement, lease space to the Community Flyfisher program for their retail store and expand parking for the restaurant. By the time the Section 108 funds became available, the property's tenant had mounted a legal and political campaign to retain tenure at the property in perpetuity, even though the NYDEC had concluded that the property was surplus. Through a subsequent DEC administrative proceeding it was ruled that the tenant's rights to occupy the property would extinguish upon transfer of the property from DEC to a buyer. DEC is now working to transfer the property to the grantee, rather than the Developer. Further complicating this land transfer are DEC-required survey methodology requirements that differ from accepted modern survey technique. The Community Flyfisher program found suitable lease space on the southern side of Inlet Island at a similar lease rate.

Records on file indicate that both the Developer and the grantee have expended extensive resources to gain acquisition of the property. The Developer indicates they are still interested in acquiring the property if it is ever made available to them.

#### BEDI Grant

Per a telephone call of 1/9/02 from Gary Clugston to Nels Bohn, it our understanding that the concern raised in the draft audit about the method of procurement and selection of a contractor by the Developer for the site remediation work will be removed from the final audit.

The audit identified a total of \$21,164.78 as ineligible costs and \$31,664.73 as unsupported costs from this funding source. The largest category of disputed costs are for interest charges associated with covering the time period from when the site remediation work was undertaken in the spring of 1999 and when BEDI funds were accessible to the Developer for reimbursement in August 2000. We submit that interest costs for this time period were necessary and reasonable project expenses.

Given the BEDI requirements and the particular circumstances of the project, interest costs were a necessary project cost. Due to terms of the BEDI grant agreement, BEDI funds must be drawn down on a pro-rata basis in conjunction with Section 108 loan advances. Per applicable CDBG regulations, Section 108 loan funds can only be disbursed on a pro-rata basis with other project financing, essentially requiring building construction to commence prior to any disbursement of Section 108 loan funds. Since a significant portion of the restaurant building's footprint overlaps with the site remediation area, the site remediation work had to precede building construction, thereby requiring the Developer to finance the up-front costs of remediation until BEDI funds could be secured.

If one agrees that interest costs were necessary, then the issue of reasonableness must be addressed. In the spring of 1999, the Developer found themselves facing a large bill from their site remediation contractor, but unable to access BEDI funding. In addition, the contractor was charging a 2% interest per month on the unpaid balance. The Developer sought and received personal loans from the partners and their relatives to raise the cash to pay the contractor well over \$200,000. The loans were evidenced by written promissory notes with an interest rate established at 9.5% annually, just below prevailing market rates available from commercial lenders. Furthermore, there were no closing costs charged for these loans. We submit that these interest payments to identity of interest entities in the amount of \$24,619.91 are reasonable and resulted in lower interest charges than if the Developer sought loan financing from a local commercial lender. Furthermore, we believe the \$7,668.73 in interest charged to the Developer by the site remediation contractor is another form of a necessary and eligible interest cost, rather than an ineligible cost as identified in the draft audit.

The other ineligible cost identified in the audit is a payment of \$13,496.05 to Iacovelli Bros., the contractor who prepared the building site and constructed the restaurant building foundation. The audit identified this cost as ineligible because the "costs do not pertain to site remediation where incurred after Certification" (by NYDEC). Although this cost was incurred after receipt of the NYDEC certification that the soil contamination had been adequately removed, the work by Iacovelli was directly related to the site remediation. The work involved removal of debris that was back-filled in one area of the remediation area by the site remediation contractor. In addition, the work returned that portion of the site to grade with #4 stone so the site would structurally support redevelopment of the site.

The Developer explained to the grantee at time of submission of the request for payment that the work was necessary to correct site remediation deficiencies associated with the material used to backfill one area of the site. In testing the soils for the foundation, Iacovelli discovered a "hole" of organic debris in the site remediation area that was different from the rest of the remediated area. To properly prepare the site for the foundation, debris from the "hole" was removed and stone brought in to return the area to grade.

The argument supporting this cost as an eligible BEDI cost is that site remediation is not complete simply when the soil contamination has been removed, but only after the site has been brought back to grade in a manner that supports the intended reuse as a new restaurant. In fact, the BEDI grant requires redevelopment of the site as a condition of the award. This cost was authorized for payment to the Developer based on a verbal explanation of the nature of the work conducted to support the written invoice, but we recognize now that the written documentation lacks adequate detail. The Developer has requested a certified statement from Iacovelli Bros. further specifying the work performed.

A payment of \$6,763.50 to GAI Environmental Services, Inc. for environmental soil testing at the project site was identified as an ineligible cost because the cost was incurred prior to the date of the BEDI application. The environmental testing was necessary to document and characterize site contamination thereby making site remediation eligible for BEDI assistance.

HUD approved the grantee's request for a pre-award approval authorizing future payment for cost incurred prior to grant approval. The grantee concluded that the cost of environmental investigation is an eligible project cost associated with site remediation. As the BEDI grant agreement does not require a Developer match for the site remediation activities, the grantee authorized reimbursement for this cost as an eligible pre-award BEDI project cost.

### CDBG Loans

The audit asserts that two loans from the IURA-administered Community Development Revolving Loan Fund (CD-RLF) awarded to the Developer to assist in covering cost overruns are unsupported because the grantee's Section 108 loan application stated that the developer was responsible for any project cost overruns. Because the CD-RLF is capitalized from CDBG program income, the audit concluded that CDBG funds were not allowed to be used to assist in covering project cost overruns.

We submit that the Developer was responsible for reasonable cost overruns, but that the scope of the overruns, estimated at \$600,000 at the time the loans were approved, but eventually rising to over \$1.1 million based on the Developer's accountant's statement of project expenses, was far above a normal or expected range of cost overrun. The grantee faced the very real prospect of the project failing. The Developer, the grantee and the grantee's economic development consultant met to analyze the impacts of the overruns on the pro forma and project feasibility, and determined that partial loan assistance from the grantee was appropriate to rescue the project. The grantee agreed to lend 25% of the \$600,000 cost overrun on the condition that the Developer covered the remaining \$400,000 gap, including an additional equity injection of \$200,000.

Based on the Developer's total project expenses, the two CDBG loans totaling \$150,000 account for less than 15% of the ultimate cost overrun, with the remainder was covered with non-federal funds. The CDBG loans require repayment by the Developer and the grantee was careful to ensure that such funding did not exceed the allowable thresholds for federal funding assistance per FTE job created.



Section 108 Grant

The grantee awarded a \$50,000 deferred loan to the Developer from the Section 108 grant funds earmarked for the waterfront promenade trail to implement components of the waterfront promenade trail. Per the executed 3/14/01 loan agreement, the Developer agreed to provide the grantee with the following benefits in return for the loan assistance:

1. grant the right for public use of the restaurant's privately-owned parking area (approximately 33 spaces) at no charge as trailhead parking for the public waterfront promenade trail,
2. make improvements to facilitate a waterfront dock walkway along the Barge Canal on the restaurant property and grant a permanent public easement to allow the public to access and use the dock walkway;
3. maintain the publicly-owned parking located in the immediate vicinity (approximately 20 stalls); and
4. grant a permanent 25-foot wide easement for the public waterfront promenade trail across approximately 120 linear feet of private property along the Flood Control Channel.

The grantee considers the above purchased benefits for the public waterfront promenade to constitute fair and reasonable compensation for the loan assistance.

Our position is that the loan was an efficient use of grant funds to gain valuable public access and convenient trailhead parking that are necessary for the success of the promenade trail. Viewed in this context, the primary issue is whether the grantee received benefits/rights of reasonable and comparable value to the \$50,000 deferred loan, not that the Developer documented that the loan proceeds were injected into the project as documented by cost receipts for project furniture, fixtures & receipts.

It is important to note that the grantee is working to significantly expand the scope of the promenade trail into a destination recreational resource to draw people to Inlet Island rather than the more modest amenity described in the original CCI application. Adequate trailhead parking will be critical to its success. The grantee has committed additional funds into the waterfront promenade trail, even though the CCI award did not require any local match for this component. The City has earmarked \$175,000 of local funds to augment CCI funding for development and construction of the promenade. Moreover, the City submitted a \$560,000 grant application to the NYS Clean Air/Clean Water Bond Act for additional funds to implement the full waterfront promenade trail.

## Finding 2 - Monitoring

Due to a combination of staff vacancies, a small staff size and a heavy workload, we were unable to conduct as much formal on-site monitoring of sub-recipients as desired for the period audited. Nevertheless, our records show that INHS has uniformly met performance goals and implemented programs on budget. Measured on a per-unit basis (\$861/unit) or as a percentage of CDBG funding (8%), INHS delivery fees appear to be very reasonable (see attached table “*INHS Delivery Fees for CDBG Programs 1996-1997*”). During the audit time period the grantee recognized the importance of monitoring and created a “grants monitor” job position, increasing the staff to four full-time employees administering HUD funding.

### Inadequate Support for Program Costs

We concur that program delivery fees paid to INHS for the seven activities audited were not properly documented by timesheets, invoices, or other evidence of direct costs, but we believe the delivery fees were reasonable and necessary in light of the documented record of program achievements and a review of sub-recipient files evidencing extensive efforts carried out by INHS to successfully implement the housing rehabilitation and home ownership activities reviewed.

Grantee has already instituted corrective action that requires future requests for payments for delivery charges are supported with direct cost documentation of costs incurred by the sub-recipient. INHS has been informed that future requests for payment must include evidence of direct costs incurred, such as timesheets and invoices rather than a negotiated fixed delivery fee.

A recent on-site monitoring visit included inspection of files that demonstrated that INHS maintains records evidencing the following scope of work for home rehabilitation and home ownership activities:

#### Home Rehabilitation –

- service request form/intake
- inspection report
- work write-up
- specifications/drawings
- bids/bid summary
- owner/contractor agreement/change orders
- pay-out approvals
- final acceptance of work
- ledger sheet
- certificate of compliance

#### Home Ownership –

- application/intake
- income verification
- house inspection & work write-up
- income/expense statement
- coordination with private/public lenders
- loan underwriting, including a credit report and verification of employment & due diligence
- loan commitment letter
- promissory note

- mortgage

Furthermore, the attached table “*INHS Delivery Fees for CDBG Programs 1996-1997*” shows that shows that the INHS activities audited were successfully administered and program objectives were achieved.

Performance of delivery work by INHS is confirmed by a very close working relationship between INHS and the City that includes City/IURA membership on INHS committees directly overseeing implementation of the activities. For instance, the INHS Rehabilitation Committee is chaired by a member of the Planning & Development Department and must approve each rehabilitation project. Similarly, the INHS Loan Committee approves each loan commitment. The Director of Community Development for the IURA is a member of this loan committee. Moreover, the INHS Board of Directors includes two members of the City’s Department of Planning and Development.

### Rehabilitation Work Not Supported

Prior to the audit finding, grantee staff discovered that \$22,657 in CDBG funds were mistakenly paid to the sub-recipient in advance of rehabilitation work being completed in the Southside Home Improvement Program, Phase II. Grantee requested and received a rebate of the over-paid funds from the sub-recipient and a letter certifying that any interest earned on the pre-payment will be provided to HUD.

After the audit fieldwork was completed, the sub-recipient submitted documentation that the rehabilitation work in question has been satisfactorily performed, including final approval of the construction work by the homeowner.

## Finding 3 – Management Controls

UDAG Program Income Used to Pay Settlement Claim

The draft audit questioned the use of \$57,000 in UDAG program income to settle a legal claim filed against the grantee by a former employee.

In our view, the grantee was protecting the federal financial interest and the best interests of the CDBG program when it settled the notice of claim without litigation. The settlement represented a compromise fairly reached between the grantee and a former employee to the benefit of all parties.

After consultation with the grantee's Attorney, the grantee determined it was in the best interest of the CDBG program to settle the notice of claim, effectively resulting in the employee's resignation. Considerations in this decision included:

1. the legal costs of litigation;
2. the staff time required for litigation;
3. the impact on the grantee's ability to effectively and efficiently administer and implement CDBG programs while litigation against a key employee proceeded;
4. the risk of losing the initial litigation and the cost of an appeal; and
5. the on-going organizational dysfunction stemming from management's dissatisfaction with an employee and the employees dissatisfaction with management.

Overall, the grantee concluded that the cost of a negotiated settlement outweighed the cost of not settling an imminent legal claim. The settlement was critical to the grantee's successful ability to properly plan and execute community development activities.

It is our understanding that, per the UDAG close-out agreement, UDAG program income is deemed as miscellaneous revenue, the use of which is not governed by 24 CFR Part 570. Such miscellaneous revenue may be used for activities eligible under Title I of the Housing and Community Development Act of 1974, as amended (the Act). We believe that this use of UDAG program income was consistent with the Act's primary objective to develop viable urban communities by providing decent housing and suitable living environments and expanding economic opportunities. Specifically, we view the activity as an authorized eligible activity under Section 105(a)(12) and Section 105(a)(13).

Section 105(a)(12)(B)(v) of the Act authorizes "activities necessary ... to develop a policy-planning-management capacity" so that the recipient may more rationally and effectively "carry out management, coordination, and monitoring of activities necessary for effective planning implementation." As stated above, a major consideration in the decision to settle the claim was to eliminate interference with the grantee's ability to manage and carry out effective planning implementation.

Section 105(a)(13) of the Act authorizes "payment of reasonable administrative costs related to planning and execution of community development and housing activities..." We believe the use of UDAG program income in this case was a reasonable administrative costs.

Unsupported Costs - \$130,000 in HODAG program income funds unsupported

The City erred in its agreements with INHS by not specifying that use of HODAG funds must be limited to support “the construction, rehabilitation or operation of real property to be used primarily for low and moderate income residential rental purposes” as required by the HODAG close-out agreement and requiring documentation of how HODAG program income was used. INHS mistakenly concluded that such funding was available for general administrative expenses to support their general operations and deposited HODAG funds in their Operating fund rather than the Rental Management fund. Part of the confusion is caused by the manner in which the City structures assistance to INHS through the City Controller’s office. In each of the two years examined in the audit, the City provided INHS with \$85,000 in assistance through a single annual agreement, of which \$65,000 was derived from HODAG program income and \$20,000 from non-federal funds.

One of the three major programs operated by INHS is the development and operation of rental housing for low/mod income persons. INHS owns and operates a rental housing program that includes 97 housing units, of which low/mod persons at affordable rent levels occupy the vast majority.

In the past INHS has not kept time records for the various activities that its employees engage in. Nor has INHS developed an approved indirect cost plan to allocate out indirect costs. While HODAG funds were deposited into the Operating fund, this fund provides significant financial support for the Rental Management fund in the form of staff, office space, office equipment and supplies. Considering just direct costs of personnel, INHS estimates that the Rental Management function received more than \$77,000 in 1999 and over \$85,000 in 2000 from the time of personnel paid from the Operating fund (see attached table “*Ithaca NHS – Operations Contribution to Rental Management 1999-2000*”). This calculation is based on a time study conducted three years ago and INHS Executive Director’s analysis of tasks performed by each employee and the each employee’s corresponding allocation of time spent on the rental program for each employee. This contribution from the Operations fund to the rental program exceeds the HODAG income received in each year.

To remedy this deficiency, the City will develop a separate agreement with INHS for the use of any HODAG funds in the future. Such agreement will require documentation on how INHS uses HODAG program income for an eligible activity and will further require submission of time sheets or other appropriate documentation as a condition of payment. INHS has agreed to have their employees each maintain time records by funded activity in the future.

Unsupported Payments to Contractor

The audit indicated that \$20,916 of payments to an independent contractor lacked adequate documentation as contractor invoices/time sheets only specified the amount of hours spent on each program. Because this independent contractor was implementing two housing rehabilitation programs he maintained regular office hours in the IURA offices at City Hall to be easily available by property owners and contractors, so grantee management on a regular basis oversaw his work. The contractor attended weekly staff meetings. Furthermore, the contractor reported to an IURA oversight committee to gain loan approvals and to provide status reports on a regular basis.

To address this finding, the independent contractor is now attaching further documentation to their timesheet identifying what specific services were performed. To prevent such a finding in the future, the grantee's standard contract form for independent contractor services has been modified to specifically require documentation on contractor invoices to identify specific services performed during the billing period.

### **Inadequate Segregation of Duties**

The grantee agrees to adopt policies and institute procedures to further segregate duties to the extent practicable given the small staff size. Procedures will be established to provide for adequate separation of duties for those individuals who maintain control over cash.

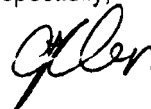
### **Assets Not Properly Safeguarded**

The grantee agrees to adopt controls recommended in the audit to assure that assets are adequately safeguarded. Please note that the grantee has instituted the use of new checks that specify that a check can only be issued and cashed by a recipient with two signatures from the grantee.

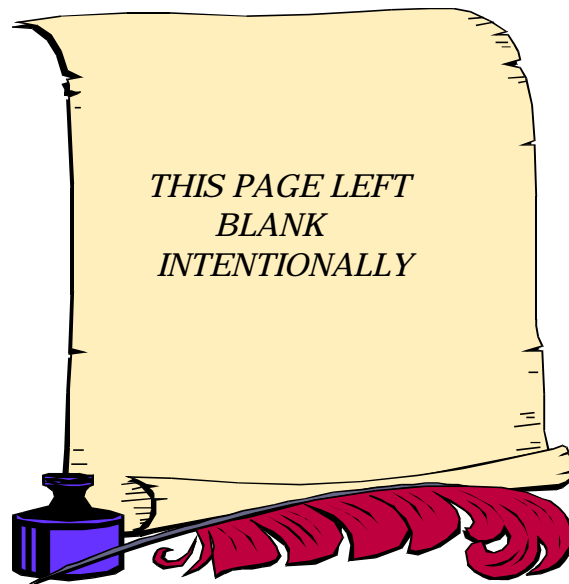
We request clarification of the issue raised with respect to reimbursing employees for out-of-pocket costs, where no purchase order is prepared, if the employee is required to submit a receipt and such reimbursement is approved by management for payment. It appears that a payment voucher system for every payment will be unnecessarily unwieldy for small purchases, especially in light of the fact that the grantee does not maintain a petty cash fund.

I very much appreciate this opportunity to provide comments and look forward to working with you and the HUD-Buffalo office to resolve any outstanding issues and improve our performance.

Respectfully,



Alan J. Cohen  
Mayor



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