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| Issue Date December 20, 2006 |
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| Audit Report Number 2007-NY-1002 |
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TO: Nancy Peacock, Director, Community Planning and Development, 2CD

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: The City of Amsterdam, New York, Needs to Make Improvements in Administering Its Section 108 Loan Guarantee Program

HIGHLIGHTS

What We Audited and Why

We audited the operations of the City of Amsterdam, New York (grantee), regarding its administration of a Section 108 loan obtained in May 2002 under the U.S. Department of Housing and Urban Development's (HUD) Canal Corridor Initiative. The purpose of the examination was to determine whether the grantee ensured that (1) Section 108 loan proceeds were disbursed in accordance with Community Development Block Grant (Block Grant) and Section 108 loan rules and regulations and (2) its Section 108 loan project properly complied with Block Grant program objectives.

What We Found

The grantee did not disburse Section 108 loan proceeds in accordance with Block Grant and Section 108 loan rules and regulations. Specifically, (a) some loan proceeds were not disbursed in accordance with the loan application while other funds were disbursed without adequate support, and (b) there is no evidence of compliance with labor standards. As a result, the grantee could not demonstrate that loan proceeds totaling \$535,000 were used for proper, reasonable, and eligible costs.

What We Recommend

We recommend that the director of HUD's Buffalo Office of Community Planning and Development instruct the grantee to submit supporting documentation to justify all unsupported costs, so that HUD can make an eligibility determination, and reimburse the program from nonfederal funds all amounts determined to be ineligible. We also recommend that the grantee develop administrative controls that will ensure compliance with all Section 108 loan guarantee regulations and requirements for all future Block Grant-related funding.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the results of our review during the audit and at an exit conference held on November 28, 2006. Grantee officials generally agreed with our findings and provided their written comments during the exit conference. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

| | |
|---|----|
| Background and Objectives | 4 |
| Results of Audit | |
| Finding 1: There Were Weaknesses in the Grantee’s Administration of Its Section 108 Loan Guarantee Program | 5 |
| Scope and Methodology | 9 |
| Internal Controls | 10 |
| Appendixes | |
| A. Schedule of Questioned Costs | 12 |
| B. Auditee Comments and OIG’s Evaluation | 13 |
| C. Section 108 Loan Application Sources and Uses Table | 19 |

BACKGROUND AND OBJECTIVES

The City of Amsterdam, New York (grantee), incorporated in 1804, was established within the County of Montgomery and is governed by its charter, various local laws, and other general laws of the State of New York. The mayor is responsible for overall operations and serves as the chief executive officer, and the controller serves as the chief fiscal officer. All legislative power of the grantee is vested in the common council whose powers are specified in the city charter. The books and records for the Section 108 Loan Guarantee program are located at City Hall, Amsterdam, New York.

In December 1996, the U.S. Department of Housing Urban Development (HUD) was the administrator for the State of New York's Small Cities Community Development Block Grant (Block Grant) Program and, therefore, became the sponsor of the Canal Corridor Initiative, which was introduced to revitalize communities along the Erie Canal and related waterways in upstate New York. In September 2000, the State of New York agreed to administer the Small Cities Block Grant Program, while HUD continues to administer the Canal Corridor Initiative. The Canal Corridor Initiative sought to promote tourism that would spark economic development across upstate New York with emphasis on job creation. The Canal Corridor Initiative was authorized by the Housing and Community Development Act of 1974 and was designed to provide grants and loan guarantees to communities along the waterways for economic development projects. As part of the Canal Corridor Initiative, the grantee applied for a Section 108 loan guarantee in the amount of \$535,000 for a restaurant/banquet facility renovation project.

In February 2001, the grantee received notice from HUD that its request for loan guarantee assistance under the Section 108 Loan guarantee program had been approved (Project No: B-00-DC-36-0001-B). The loan proceeds, provided to a local development corporation in July 2002, were to be used for a Canal Corridor Initiative, which involved funding for interior and exterior renovations of a restaurant/banquet facility. The grantee used the creation of 34 jobs as criteria for meeting a national objective as required by section 570.208 of the Block Grant regulations. The restaurant/banquet facility closed before the beginning of our audit, and the Section 108 loan is currently in default.

We selected the grantee for audit based on indicators from monitoring reports, local media coverage, and an analysis of the most recent single audit report on the City of Amsterdam, New York. In addition, our review of the Canal Corridor Initiative in 2001 identified issues relating to other funded grantees' ability to carry out Section 108 Loan Guarantee program activities and noted that program objectives, such as job creation, had not been fully realized.

The objectives of our audit were to determine whether the grantee ensured that (1) loan proceeds were disbursed in accordance with Block Grant and Section 108 loan rules and regulations and (2) its Section 108 loan project complied with Block Grant program objectives, including the intended benefit of job creation.

RESULTS OF AUDIT

Finding 1: There Were Weaknesses in the Grantee's Administration of Its Section 108 Loan Guarantee Program

Contrary to HUD requirements, the grantee did not implement adequate program controls and procedures to ensure that a Section 108 loan to a local development corporation complied with applicable HUD regulations. Specifically, (a) some loan proceeds were not disbursed in compliance with the loan application while the remaining funds were not adequately supported, and (b) there is no evidence of compliance with labor standards. As a result, the grantee could not demonstrate that loan proceeds totaling \$535,000 were used for proper, reasonable, and eligible costs. These deficiencies can be attributed to the grantee's inadequate system of controls over its Section 108 Loan Guarantee program.

Loan Proceeds Were Not in Compliance with the Loan Application and/or Not Adequately Supported

Section 108 loan proceeds amounting to \$24,069 were used to pay various closing costs associated with the loan, including title insurance, attorney fees, interest, and delinquent property taxes; however, although these costs may not have violated a HUD regulation, they were not in accordance with the approved Section 108 loan application between HUD and the grantee. The approved Section 108 loan application documents the sources and uses of project funds as described in Appendix C of this report.

Moreover, an examination of the loan files showed that the grantee did not maintain adequate documentation, such as contracts, invoices, or cancelled checks, to support the actual renovation costs. At the loan closing, the grantee disbursed the remaining loan proceeds of \$510,931 to the development corporation without any evidence supporting the propriety of the renovation costs or that the funds were used in accordance with the loan agreement. Title 24, Code of Federal Regulations (CFR) Part 570.506(h) provides that the grantee shall maintain evidence to support how the Block Grant funds provided to an entity are expended. However, the grantee provided the loan funds without ensuring that the use of such funds was in accordance with the approved Section 108 loan application, or with regulations.

For example, the approved Section 108 loan application included \$40,000 for landscaping and \$34,000 for demolition. According to documentation maintained by the grantee, the project called for the demolition of the motel units located adjacent to the restaurant/banquet facility on the property. Once demolished, the area was to be relandscaped.

In August 2006, we toured the restaurant/banquet facility and grounds and noticed that the motel units were still intact, contrary to the approved Section 108 loan application. Moreover, since the motel units were not demolished, the area had not been relandscaped as planned.

The following photographs illustrate our concern regarding the use of the Section 108 loan proceeds.



Motel units adjacent to restaurant/banquet facility that should have been demolished

In addition, \$46,000 was allocated for resurfacing the parking facilities on the property; however, during our visit, we found that only a small area had been resurfaced and the majority of the parking area and entrance way were in general disrepair.



Pavement deterioration in the parking facility

The Grantee Could Not Demonstrate Compliance with Labor Standards

Our examination of the project files did not reveal evidence that the grantee complied with labor standards for the Section 108 loan program. The files did not document that rehabilitation and construction contracts associated with the project were monitored as required by HUD Handbook 1344.1, REV-1, Federal Labor Standards Compliance in Housing and Community Development Programs. More specifically, the project files did not contain evidence that the grantee (1) obtained the required wage determinations, (2) held a preconstruction conference to inform contractors and subcontractors of their responsibilities and obligations, (3) obtained contractor and subcontractor weekly payrolls, or (4) conducted employee interviews as required. As a result, labor standards violations may have occurred and remain undetected.

Conclusion

The above deficiencies show that the grantee did not administer its Section 108 Loan Guarantee program in an efficient and effective manner. As a result, HUD funds were used for costs that may not be necessary or reasonable.

Recommendations

We recommend that the director, Buffalo Office of Community Planning and Development, instruct the grantee to

- 1A. Provide documentation to justify the \$535,000 in unsupported costs, so that HUD can make an eligibility determination, and reimburse from nonfederal funds the amount of any unsupported costs determined to be ineligible.
- 1B. Develop administrative control procedures to ensure compliance with all Section 108 Loan Guarantee program regulations and requirements for all future Block Grant-related funding.

SCOPE AND METHODOLOGY

Our review focused on the grantee's administration of a \$535,000 Section 108 loan obtained under HUD's Canal Corridor Initiative. To accomplish our objectives, we interviewed HUD officials and grantee staff. In addition, we reviewed applicable laws, regulations, and other HUD program requirements and the grantee's program files for the Section 108 loan program.

Various documents, including board minutes, financial statements, bank statements, check vouchers, HUD monitoring reports, and the grantee's audited financial statements, were also reviewed during the audit.

The review covered the period between January 1, 2002, and April 30, 2006, and was extended as necessary. We performed audit work from May through August 2006. The review was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

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

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The grantee did not establish controls and procedures to ensure that administration of the Section 108 Loan Guarantee program was conducted in compliance with program rules and regulations (see finding).
- The grantee did not have an adequate system to ensure that resources were properly safeguarded when costs that were not in accordance with the approved Section 108 loan application were paid and when it did not maintain adequate supporting documentation(see finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

| Recommendation number | Unsupported 1/ |
|--------------------------|----------------|
| 1A | \$535,000 |

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



JOSEPH EMANUELE III, MAYOR
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November 30, 2006

Karen Campbell, ARIGA
U. S Department of HUD
26 Federal Plaza, Room 3430
New York, New York 10278

Dear Ms. Cambell:

The following is the City of Amsterdam response to Hud Office of Inspector General draft audit dated November 16, 2006.

Finding One:

Weaknesses in the Grantee's Administration of its Section 108 Loan Guarantee Program.

Municipal Response:

The City concurs with the OIG's statement that the City of Amsterdam had inadequate program controls and procedures. The City further concurs with the OIG conclusion that the grantee did no administer its 108 Loan Guarantee program in an efficient and effective manner.

However, the City of Amsterdam wishes to make it clear that the personnel who administered the 108 program through the City's Community and Economic Development Department no longer work for the City, and those currently working for the City are not responsible for the lack of oversight that occurred at the time the Section 108 loan to Milltown Development was administered. In fact, the Community and Economic Development Department was abolished by the City in 2004, because the majority of the members of the City Council felt that the cost of the department was not an effective use of taxpayer's funds and the department failed to achieve substantial community development goals. Responsibility for administering HUD programs reverted to the Amsterdam Urban Renewal Agency, which had traditionally administered State and Federal programs in an effective manner.

With regard to specific issues under finding one, the City's response is as follows:

Page -1-

Comment 1

Comment 2

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 3

Issue #1:

\$24,069 was used to pay for items (closing costs) not approved in the 108 loan documents and therefore an ineligible use of loan proceeds.

Response:

The City agrees that the loan documents called for all 108 proceeds to be utilized for building renovations rather than acquisition and soft costs. As such, any use of 108 funds for closing costs is inconsistent with the agreements between the City and HUD for use of 108 funds. However, a distinction should be made between violation of a project specific agreement between HUD and the City, and a violation of HUD regulations in general. There is, to the City's knowledge, no HUD regulation that prohibits use of 108 funds to make loans, and no prohibition against using 108 proceeds to cover closing costs. Therefore, in the instance of the Milltown Development loan, the use of 108 proceeds for closing costs did not violate HUD regulations, but it was clearly inconsistent with the agreements between the City and HUD for this project. The reason that the City is making this distinction is to avoid the draconian penalty of having to reimburse HUD out of local taxpayer funds due to violation of a federal regulation. In its plan to resolve the findings, the City's goal will be to document that the total projected investment in the project (both 108 proceeds and owner equity) was made, and that the use 108 funds for closing costs was simply a matter of shifting of funds around, rather than a misappropriation of funds, or failure by the borrower to comply with matching funding requirements.

Issue #2:

\$510,931 in loan proceeds are unsupported

Response:

At the time of the OIG audit, the City had no supporting documentation for the use of \$510,931 in 108 loan proceeds, which were disbursed to the borrower in single check. Of further concern, many of the construction items, as outlined in the source and uses of funds statement, were not completed, as discussed in the audit report. Clearly, the City failed to monitor this project in an acceptable manner. With that said, such shortcomings do not mean that 108 funds were expended in violation of HUD regulations. As a possible explanation, the developer could have spent his own funds and 108 funds in the amounts specified, and construction cost overruns prevented the developer from completing all originally contemplated tasks. Generally, economic development projects are a "best efforts" venture, and despite spending the required amounts of matching funding, all tasks may not have been completed. The City's approach to this issue will be to contact the developer and assemble cost documentation to support the use of 108 funds as well as matching funds.

Comment 4

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 5

Issue #3:

Job creation goal of 55 jobs was not attained, and that the requirements of CFR 570.208(a)(4) were not met.

Response:

The City agrees that the goal of creation of 55 jobs was mentioned in numerous documents relating to the 108 loan. However, the City believes that the actual job goal in the final documents was 34 jobs. There is no question that the project fell far short of that goal, with the "high water" mark of 5 jobs. However, under CFR 570.208(a)(4), for an activity that creates jobs, the recipient must document that at least 51 percent of the jobs will be held by, or will be available to, low- and moderate-income persons. In this instance, the City documented 5 jobs, all of which were low/mod jobs. Therefore, it is the City's position that the provisions, of CFR 570.208 (a)(4) were met, albeit being woefully short of the originally promised goals.

Comment 6

Issue #4:

There was no documentation of compliance with Federal Labor Standards.

Response:

The City concurs that there is no documentation in its possession regarding compliance with HUD Handbook 1344.1, Federal Labor Standards for this project. At this point, it is not possible to obtain "after the fact" wage determinations, or re-create payroll records or job site monitoring records for a project completed several years ago. In addition, the legal obligation comply with such regulations lies with the developer, who is now in bankruptcy. The City feels that, under the circumstances, "after the fact" documentation of labor standards compliance is an insurmountable task.

Recommendations:

The OIG makes three recommendations to HUD Buffalo with regard to this 108 loan. These include:

- 1A. Reimbursement of \$24,069 in 108 funds used for closing costs.
- 1B. Provision of documentation to justify \$510,931 in unsupported costs, and
- 1C. Development of administrative control procedures on the part of the grantee to ensure compliance with applicable regulations and program requirements.

The City's comments on these recommendations are as follows:

Comment 7

- 1A. As discussed earlier in this response, the use of 108 funds for closing costs is not a violation

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 7

of HUD regulations, and the City is requesting that it be provided the opportunity to demonstrate that all project funds, both 108 and developer equity were duly expended on this project. If such proves to be the case, the City is requesting that the sources and uses of funds be amended (subject to HUD regulations) to indicate a total investment equal to or greater than the originally contemplated investment. In such case, the 108 funds could be construed as simply being shifted around on the budget sheet, rather than being misappropriated and subject to recapture.

Comment 8

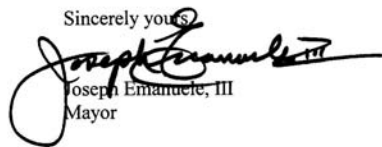
1B. The City concurs with recommendation 1B and will seek documentation to support the use of all 108 funds.

Comment 9

1C. The City maintains that it already has complied with recommendation 1C. Personnel currently working with the City of Amsterdam are highly experienced and qualified to administer any future HUD programs, and have established administrative control procedures to ensure compliance with HUD regulations.

In closing, I wish to pledge the City of Amsterdam's full support in addressing these findings, and working with the Buffalo area office in a cooperative manner to resolve any outstanding issues.

Sincerely yours,



Joseph Emanuele, III
Mayor

OIG Evaluation of Auditee Comments

- Comment 1** Officials for the Grantee agree with our conclusion that the Grantee had inadequate program controls and procedures, and that the Grantee did not administer its Section 108 Loan Guarantee program in an efficient and effective manner.
- Comment 2** Officials for the Grantee state that the personnel who were responsible for administering the Section 108 Loan Guarantee program are no longer employed by the Grantee, and those currently employed by the Grantee are not responsible for the lack of oversight that occurred at the time the Section 108 loan administered. Our evaluation is based on the records and documentation relevant to the Section 108 loan at the time the loan was being administered by the Grantee, and although various staff members are no longer employed by the Grantee, the Grantee is still responsible for the resolution of these issues.
- Comment 3** Officials for the Grantee agree that the loan documents called for all Section 108 loan proceeds to be utilized for building renovations rather than acquisition and soft costs and that the use of Section 108 funds for closing costs is inconsistent with the agreements between the Grantee and HUD pertaining to the sources and uses of the Section 108 funds. The Grantee further states that there is no regulation that prohibits the use of Section 108 funds to cover closing costs. We have taken into consideration the response provided by the Grantee and have revised finding 1 to reflect that the use of Section 108 funds for closing costs, although not a violation of HUD regulations, it is not in accordance with the approved Section 108 loan application between the Grantee and HUD. Accordingly, we have reclassified these costs as unsupported pending a HUD review and eliminated the draft recommendation to reimburse ineligible costs pertaining to the closing costs associated with the loan.
- Comment 4** Officials for the Grantee generally agreed with our conclusion that the disbursement of loan proceeds is unsupported. Thus, the grantee will contact the developer and assemble cost documentation to support the use of 108 funds as well as matching funds.
- Comment 5** Officials for the Grantee contend that the provisions of CFR 570.208 (a) (4) were met in that the Grantee documented 5 jobs, all of which were provided to low and moderate income persons. As such, we have eliminated the job creation issue from the finding.

- Comment 6** Officials for the Grantee concur with our conclusion that there is no documentation to support compliance with Federal Labor Standards for this project.
- Comment 7** Grantee officials state that closing costs are not a violation of HUD regulations and request the opportunity to demonstrate that all project funds, both Section 108 and developer equity, were duly expended on this project. Further, Grantee official request that the sources and uses of funds be amended subject to HUD regulations. We have reviewed and taken into consideration the alternative recommendation provided by Grantee officials. Therefore, as noted in Comment 3, we have revised finding 1 to reflect that the use of Section 108 funds for closing costs, although not a violation of HUD regulations, it is not in accordance with the approved Section 108 loan application; accordingly, we have reclassified these costs as unsupported pending a HUD review. We have also eliminated the draft recommendation to reimburse ineligible costs pertaining to the closing costs.
- Comment 8** Officials for the Grantee concur with the recommendation to provide documentation to justify the \$535,000 in unsupported costs so that HUD can make an eligibility determination.
- Comment 9** Officials for the Grantee contend that personnel currently employed by the Grantee are highly experienced to administer any future HUD programs, and those administrative controls procedures have been established to ensure compliance with HUD regulations.

Appendix C

SECTION 108 LOAN APPLICATION SOURCES AND USES

| Estimated Cost | | | |
|-------------------------------------|----------------|----------------|---------------|
| | Total | Section 108 | Owner Equity |
| Real Estate Acquisition | \$50,000 | - | \$50,000 |
| Working Capital & Soft Costs | 17,000 | - | 17,000 |
| <i>Interior Restoration</i> | | | |
| Front Bar Room Section | 35,000 | 35,500 | - |
| Front Dining Section | 15,000 | 15,000 | - |
| Cave Section | 16,500 | 16,500 | - |
| Kitchen Section | 18,000 | 18,000 | - |
| Upstairs Section | <u>35,000</u> | <u>35,000</u> | - |
| Total | 120,000 | 120,000 | - |
| <i>Glass Restoration</i> | | | |
| Front Bar Room Section | 10,250 | 10,250 | - |
| Front Dining Section | 6,200 | 6,200 | - |
| Cave Section | 8,010 | 8,010 | - |
| Upstairs Section | <u>7,500</u> | <u>7,500</u> | - |
| Total | 31,960 | 31,960 | - |
| <i>Building Services</i> | | | |
| Heating/Air Conditioning | 45,000 | 41,200 | 3,800 |
| Electrical | 22,000 | 22,000 | - |
| Refrigeration | 14,000 | 14,000 | - |
| Plumbing | <u>10,000</u> | <u>10,000</u> | - |
| Total | 91,000 | 87,200 | 3,800 |
| <i>Kitchen/Restaurant Equipment</i> | | | |
| Hard Appliances | 88,000 | 68,000 | 20,000 |
| Dishes, Glasses & Cutlery | 16,000 | 10,000 | 6,000 |
| Cookware | 6,000 | 6,000 | - |
| Tables, Chairs & Stools | 15,000 | 10,000 | 5,000 |
| Point of Sale System | 46,000 | 46,000 | - |
| Misc. Furnishings | <u>5,000</u> | <u>-</u> | <u>5,000</u> |
| Total | 176,000 | 140,000 | 36,000 |
| <i>Exterior Restoration</i> | | | |
| Painting | 20,000 | 20,000 | - |
| Landscaping | 49,455 | 40,000 | 9,455 |
| Demolition | 34,000 | 34,000 | - |
| Paving | 46,000 | 46,000 | - |
| Roof | 48,340 | 15,840 | 32,500 |
| Carting Fees | <u>3,600</u> | <u>-</u> | <u>3,600</u> |
| Total | <u>201,395</u> | <u>155,840</u> | <u>45,555</u> |
| Grand Total | \$687,355 | \$535,000 | \$152,355 |