



**U. S. Department of Housing and Urban Development**  
*Office of Inspector General*  
26 Federal Plaza, Room 3430  
New York, NY 10278 0068

December 3, 2001

Audit Memorandum  
No. 2002-NY-1801

**MEMORANDUM FOR:** 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 Utica, New York  
Community Development Block Grant, Home, and  
Section 8 Existing Housing Programs  
Utica, New York

We completed an audit of the City of Utica's (Grantee) Community Development Block Grant (CDBG), Home, and Section 8 Existing Housing Programs in December 1999, but postponed issuance of a final audit report until a related on-going criminal investigation was completed. Upon completion of the criminal investigation, we performed a review to update the status of the four findings that we developed during our 1999 audit. The four findings pertained to: (1) Management Controls; (2) Rehabilitation Activities; (3) Program Administration; and, (4) Section 8 Contract Oversight. The audit period for our 1999 review was from April 1, 1997 through September 30, 1998. During our current review of the areas discussed in the four findings, we extended the audit period to include activities through June 2001. Our follow-up review was conducted during the period between July and October 2001.

Within 60 days, please provide us, for each recommendation cited in this memorandum, 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 provide us copies of any correspondence or directives issued related to this review.

If you have any questions, please contact William H. Rooney, Assistant District Inspector General for Audit at (212) 264-8000, extension 3976.

**SUMMARY**

We conducted a review of the City of Utica, New York (Grantee) operations to determine the current status of issues raised in draft findings prepared by our office in 1999. Our review disclosed that deficiencies continue to exist within each of the program areas that we examined

in 1999. As such, this memorandum contains four findings that are similar to those drafted by our office in 1999; however, the findings have been updated and modified as appropriate to include current conditions and to incorporate corrective actions taken by the Grantee to date. Specifically, we determined that the following reportable conditions exist:

*Effective Management Controls Are Needed – (See Finding 1)*

Our previous 1999 draft findings indicated that an effective organization was needed to ensure adequate management controls. The 1999 audit found that management controls were lacking or ineffective over: financial and accounting functions; program monitoring; and, programmatic communications. Because of control weaknesses, reasonable assurance could not be provided that program funds were properly used and that assets were adequately safeguarded. As a result, ineligible and unsupported costs have been charged to HUD funded programs. Our current review indicated that the Grantee instituted some corrective actions that should correct the lacking or ineffective management controls, but more needs to be done.

*Ineligible and Unsupported Rehabilitation Costs – (See Finding 2)*

Because the Grantee did not establish adequate controls over the safeguarding of assets, CDBG funded rehabilitation programs were charged with almost \$377,000 of ineligible and unsupported costs. Included in the questionable costs were disbursements associated with a former employee's theft of contractor bid deposits and disbursements for costs that were not supported or that were not reasonable and necessary. In addition, the Grantee did not adequately account for its rental rehabilitation loan program activities, nor could it identify with certainty the universe or status of loans outstanding. The deficiencies occurred because management controls did not provide for an adequate segregation of duties or establish procedures of checks and balances to ensure that accounting and transaction cycles were appropriately processed without circumvention. The deficiencies not only resulted in the improper use of program funds, but have also prevented the achievement of program objectives including providing the citizens of Utica, New York with safe and affordable housing.

*Grantee Did Not Adequately Administer or Monitor Program Activities – (See Finding 3)*

The Grantee did not implement adequate controls to ensure that its HUD program activities, including those administered by subrecipients, complied with applicable HUD regulations. Consequently, the Grantee could not demonstrate that HUD funds amounting to almost \$832,000 were used for eligible and necessary activities, or that all HUD funded activities achieved appropriate program objectives. We believe that the Grantee did not adequately administer or monitor its activities because emphasis was not placed on establishing procedures that required compliance with HUD requirements.

*Section 8 Administrative Contract Was Not Effectively Controlled – (See Finding 4)*

Besides CDBG, the Grantee administers a Section 8 Housing Assistance Program. On March 20, 1997, the Grantee contracted with Utica Community Action, Inc. (UCAI) to administer its

Section 8 Program. During the ensuing eleven months ending February 19, 1998, the Grantee did not effectively scrutinize UCAI's performance to ensure that UCAI administered the program in accordance with an established Administrative Plan and Section 8 regulations. Consequently, UCAI has expended at least \$127,352 for costs not adequately supported. We believe the cited deficiencies occurred because the Grantee did not effectively monitor UCAI's performance.

An exit conference was held at City Hall in Utica, New York on October 17, 2001, which was attended by the following Grantee and HUD officials:

City of Utica, New York

Tim Julian – Mayor

Mark Mojave – Commissioner, Department of Urban and Economic Development

Heather Mowat – Budget Director

Jim Schlager – Community Development Finance Administrator

HUD – Office of Inspector General (OIG)

Alexander C. Malloy – District Inspector General for Audit

William Rooney – Assistant District Inspector General for Audit

John Cameron – Senior Auditor

Richard Roseboom – Senior Auditor

**Background**

Title I of the Housing and Community Development Act of 1974, established the Community Development Block Grant (CDBG) Program. The CDBG Program provides grants to States and units of local governments to aid in the development of viable urban communities. The HOME Program allows participating jurisdictions to use the funds for a variety of housing activities, according to local housing needs. The Section 8 Housing Assistance Program allows the Grantee to provide rental assistance to low-income families, and to elderly and handicapped individuals who could not otherwise afford decent, safe, and sanitary housing.

The Programs referred to above are administered by the Grantee and its subrecipients. The Grantee is governed by a Mayor and Common Council. The Grantee's office is located at City Hall, Utica, New York. The Commissioner of the Department of Urban and Economic Development is Mark Mojave and the Comptroller is Joan Scalise.

During the audit period, from April 1997 through September 1998 (and extended when appropriate), the Grantee administered the following:

- CDBG Entitlement Grants for Program Years 1997 and 1998 totaling \$7,952,000.
- HOME Grants totaling \$1,734,000.

- Section 8 Housing Program approved budget of \$2,185,080.

Our initial field work was completed in June 1999. The audit resulted in the development of four draft findings, which we provided the Grantee in December 1999. Subsequently, we discussed those findings with Grantee officials during an exit conference held on January 28, 2000. The Grantee prepared draft responses to the draft findings, and presented their written comments to the Office of Inspector General (OIG) at the exit conference.

Because several issues contained in the 1999 draft findings related to an on-going criminal investigation conducted by HUD's OIG Office of Investigations, the Federal Bureau of Investigation and the U.S. Attorney's Office, we suspended issuance of a final audit report pending completion of the investigation. In this regard, the investigation concluded in December 2000, when a former Grantee employee pled guilty to a felony charge of theft of federal funds, admitting to embezzling \$113,967 in HUD funds from 1994 to 1998.

Since the original draft findings were prepared in December 1999, and because the related investigation ended a year later in December 2000, OIG decided it was prudent and necessary to conduct additional audit work to update the status of the issues raised in our 1999 draft findings, and to analyze the affects of relevant subsequent events pertaining to those issues, prior to issuing a final report. The additional audit work was deemed necessary because substantial time had elapsed since preparation of the original draft findings, and to fairly, accurately and effectively present the issues in a final audit report. Furthermore, we believed that it was essential that consideration be afforded to: subsequent developments; Grantee responses to the draft findings; and, the impact of the criminal investigation on the matters raised in the draft findings. Apart from the above, our office has received congressional inquiries regarding the status of our 1999 draft findings.

For our current review, we conducted additional audit work during July and October 2001, to reassess and determine the up to date status of the issues contained in the 1999 draft audit findings. To accomplish our objectives we: considered and evaluated the Grantee's written responses to the 1999 draft findings; reviewed documentation and correspondence generated subsequent to the 1999 audit; updated the status of the previously raised issues; evaluated relevant Grantee controls; interviewed pertinent Grantee officials; and, examined corrective actions taken by the Grantee in response to our prior audit recommendations. Particulars pertaining to the current status of reportable conditions and the deficiencies identified are contained in the findings that follow.

## **Results of Review**

### **Finding 1 - Management Controls Need To Be Strengthened**

In our 1999 draft findings we indicated that an effective organization was needed to ensure adequate management controls. Specifically, the 1999 audit found that management controls were either lacking or ineffective regarding: (a) Financial and accounting functions; (b) Program monitoring; and, (c) Programmatic communications. Because of the control weaknesses the Grantee could not demonstrate, or provide reasonable assurance, that program funds were properly used and that assets were adequately safeguarded. Consequently, ineligible and unsupported costs have been charged to HUD funded programs by the Grantee and are discussed in the other findings in this report. Our subsequent review indicated that the Grantee instituted some corrective actions that should strengthen management controls. However, to ensure that deficiencies similar to those cited in the report do not recur, additional controls must be established.

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#### Criteria

Title 24, Code of Federal Regulation (CFR), Part 570.610 of the CDBG Regulations requires grantees to comply with the policies, guidelines, and requirements of Title 24, CFR Part 85, OMB Circulars A-87 and A-110.

Title 24, CFR Part 570.501(b) provides that grantees are responsible for ensuring that CDBG funds are used in accordance with all program requirements. It further provides that the use of designated public agencies, subrecipients or contractors does not relieve the grantee of this responsibility and that the grantee is also responsible for determining the adequacy of performance under subrecipient and procurement contracts.

Title 24, CFR Part 85.20 provides that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

#### Grantee Administration

The Grantee provided the authority to administer its CDBG program to the City's Department of Urban and Economic Development. In addition to activities implemented by the Grantee, subrecipients were also used to administer portions of the Grantee's programs. Financial records for HUD funded activities are maintained by the City

## Results of Review

Controller based on information provided by the City's Department of Urban and Economic Development.

To evaluate the effectiveness of the Grantee's management and related controls, we: reviewed pertinent transaction cycles; considered previous audits; interviewed Grantee and subrecipient personnel; and, examined program documentation as appropriate.

The results of our 1999 review and draft findings disclosed that the administration of HUD programs was impeded by weaknesses in the Grantee's management controls. Consequently, the control weaknesses had the following unfavorable affects on the Grantee's operations:

### **Financial and Accounting Controls**

The lack of adequate segregation of duties precluded the Grantee from assuring that program assets were adequately safeguarded and used for appropriate purposes. In particular, controls over receipts and disbursements, procurement and contracting, and supporting documentation for costs, were less than sufficient. Specific deficiencies attributed to the weak controls are discussed in detail in the remaining findings of this report.

### **Program Monitoring Process**

The Grantee did not properly monitor HUD program activities administered in house or by its subrecipients. Findings 3 and 4 of this report identify specific deficiencies associated with monitoring of HUD funded activities.

### **Programmatic Communications**

An Independent Public Accountant's (IPA) Single Audit Report (dated March 31, 1998) contained findings related to poor communications between the City's Department of Urban and Economic Development and the City's Controller's Office. Our 1999 review confirmed the issues disclosed by the IPA and showed that financial transactions involving HUD funds were not being posted on a monthly basis. Moreover, we found that financial information required to prepare submissions to HUD was not available in a timely manner and may not be accurately recorded or

sufficiently documented to support the information provided in the submissions. For example, information about the collection of loans made with HUD funds was not reliable because the Grantee's ability to identify the universe of loans made with grant funds is questionable (See Finding 2).

#### Grantee Progress

Subsequent to our 1999 review, and based on the recommendations contained in our draft findings, the Grantee instituted certain corrective actions associated with the deficiencies identified and discussed herein. In particular, the Grantee has made efforts to improve management controls over various aspects of its operations. Specifically, the Grantee has made improvements over safeguarding of assets by establishing controls that more effectively segregate and streamline staffing duties and responsibilities. It has also strengthen controls over monitoring of subrecipients by requiring more descriptive and restrictive budgets and enhancing scrutiny of requests for reimbursement. Moreover, the Grantee is in the process of establishing procedures to conduct on-site monitoring of subrecipient activities and fiscal management. To this end, the Grantee has conducted a monitoring site visit at one of its subrecipients. Finally, efforts undertaken by the new City management officials have lead to better communications and more effective coordination between City Departments and Agencies.

#### Deficiencies still exist and corrective actions are needed

However, based on the results of our updated audit work, management controls weaknesses still exist. Specifically, the Grantee lacks adequate fidelity bond coverage, subsidiary records are not reconciled to the general ledger in a timely manner, and some cash receipts are collected by the Department of Urban and Economic Development instead of being collected by the Comptroller's Office. We informed the City management that the control weaknesses must be addressed before HUD can be assured that the Grantee is in compliance with applicable program requirements, and that the activities of the HUD funded programs are being administered in an effective and efficient manner.

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#### Auditee Comments

In summary, Finding 1 is flawed, based upon the scope of this draft audit, as to the position that "deficiencies still exist and corrective actions are needed." Accordingly, we respectfully request that this section be amended to reflect adequate standards that have been implemented to safeguard the use and administration of federal dollars.

The complete text of the Grantee's comments regarding Finding 1 is contained in Appendix C of this memorandum.

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## OIG Evaluation of Auditee Comments

As stated in the finding, we acknowledge that the Grantee has instituted certain corrective actions associated with the deficiencies identified in this report. However, contrary to the Grantee's contention that the finding is flawed, weaknesses in certain areas of its operation continue to exist and certain management controls need to be strengthened.

Specifically, although the Grantee maintains fidelity bond coverage, the coverage is not in the form of a blanket bond, thereby, leaving the Grantee vulnerable to potential losses from the acts of non-covered employees. Our review disclosed that Grantee employees, other than those covered under the bond, have collected, or are in a position to collect, funds on behalf of the City of Utica, New York. We believe the adequacy of fidelity bond coverage for the Grantee is particularly important given the seriousness of the issues raised in Finding 2 of this report, and in particular, regarding the theft of more than \$113,000 in Federal funds. It should be noted that the former Grantee employee responsible for the aforementioned theft of Federal funds was not a covered employee under the Grantee's fidelity bond.

Concerning the Grantee's comments on reconciliation of subsidiary records, we remind the Grantee that it could not provide us with adequate assurance as to the accuracy of the rental rehabilitation loan subsidiary records. In particular, Grantee officials informed us that they were unsure if the subsidiary records reflected all loans made, or if all of the loans recorded in the subsidiary records were in fact legitimate. Furthermore, the Department of Urban and Economic Development requested, in correspondence dated July 6, 2001, that the City's legal department determine the collectibility of some 15 rental rehabilitation loans. The correspondence showed balances due the City of more than \$173,000 and indicated that many of the loans have been delinquent for several years. As such, these 15 delinquent loans have continued to be carried on the Grantee's books and subsidiary records for many years despite the likelihood that they are not collectible.



Apart from the above, the Grantee's most recent completed Independent Public Accountant (IPA) audit dated December 19, 2000 for the year ended March 31, 2000 included several concerns and findings applicable to internal controls. For instance, the IPA found that Federal loans, grants, and repayments of loans are not being recorded timely or accurately to the general ledger and that duties are not properly segregated. The IPA also noted that subrecipients were not being monitored to ensure compliance with applicable Federal regulations.

As we commend the Grantee for its efforts to improve management controls, we disagree with the comments indicating that adequate standards have been implemented to safeguard the use and administration of federal dollars. To the contrary, we reiterate, as stated in the finding, that management control weaknesses still exist and must be addressed before HUD can be assured that the Grantee is in compliance with applicable program requirements and that it is administering HUD programs in an effective and efficient manner.

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## Recommendations

We recommend that you require the Grantee to:

- 1A. Establish and implement the management controls needed to correct the deficiencies cited in this finding regarding fidelity bond coverage, reconciliation of subsidiary records and cash receipts collection.

## **Finding 2 - Ineligible and Unsupported Rehabilitation Costs**

Because the Grantee did not establish adequate controls over the safeguarding of assets, the administration of its rehabilitation programs resulted in the disbursement of almost \$377,000 of CDBG funds for costs associated with a former employee's theft of contractor bid deposits and for costs that were either unsupported, unreasonable or unnecessary. Moreover, the Grantee did not adequately account for the activities administered under its rental rehabilitation loan program, nor could it identify with certainty the universe or status of loans outstanding. The deficiencies occurred because management controls did not provide for an adequate segregation of duties or establish procedures of checks and balances to ensure that accounting and transaction cycles were appropriately processed without circumvention. The deficiencies not only resulted in the improper use of program funds, but have also prevented the achievement of program objectives including providing the citizens of Utica, New York with safe and affordable housing.

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### Background

In our 1999 draft audit findings, we mentioned that because the Grantee failed to ensure that there was adequate segregation of duties pertaining to the administration of its rehabilitation programs, more than \$500,000 of CDBG funds were disbursed either for work not performed, costs not supported, or costs that were not reasonable and necessary. In addition, we mentioned that the Grantee could not identify or account for \$45,186.35 of bid security deposits received from contractors. More significantly, the Grantee was unable to identify the universe of rehabilitation loans outstanding, or whether the loans outstanding were authentic. In our subsequent follow up review of these issues, we concluded that almost \$377,000 of costs are in question. The details are as follows.

During our initial survey in 1998, we met with officials of the Grantee and the Oneida County District Attorney's Office. They advised us that significant lapses in the Grantee's system of controls had permitted at least \$234,391 in grant funds to be shown as being spent for rehabilitation work on 19 properties even though rehabilitation work was not performed at those sites. In addition, the District Attorney's Office found that at least \$45,186.35 in bid security deposits received from contractors could not be accounted for.

## Subsequent Development

Subsequent to the preparation of our December 1999 draft findings, an ongoing investigation by the U.S. Attorney's Office, the FBI, and HUD's OIG (Office of Investigation), into activities of a former City of Utica, New York employee was completed in December 2000.

As part of the investigation, HUD OIG's Office of Investigation examined the \$234,391 of disbursements originally identified by the Oneida County District Attorney's Office. The examination showed that the \$234,391 disbursed was based on invoices fraudulently created by the former City employee. The investigation also showed that the \$234,391 disbursed related to both legitimate amounts due contractors for actual invoices submitted to the Grantee, and additional amounts paid to contractors to offset stolen bid security deposits. In an attempt to conceal the theft, the former City employee admitted to destroying certain contractor invoices received and replacing them with fraudulently created invoices. By doing so, the former employee could process payments that included both: legitimate amounts due the contractor; and, amounts needed to offset the stolen bid deposits.

## \$113,967 of Ineligible Costs Were Used to Offset Stolen Bid Deposits

The former City employee was able to perpetrate the fraud not only because the employee had complete control over the Grantee's rehabilitation program, but because inadequate systems of checks and balances existed to detect the wrongdoing. The investigation concluded with a conviction of the former City employee who pled guilty to a felony charge of theft of Federal funds by admitting to embezzling \$113,967 in HUD funds from 1994 to 1998. Accordingly, the \$113,967 of costs charged to the program was not necessary or reasonable and is therefore ineligible.

## Scope and Methodology

As mentioned in our 1999 draft finding, to address the issues and to determine the extent of program losses, we: examined pertinent records and files; performed site visits to rehabilitated properties; and, evaluated the Grantee management's administrative and financial controls. In this regard, and because of the deficiencies originally identified by the Oneida County District Attorney's Office and other control weaknesses noted during the survey, a sample of rehabilitation activities associated with six other properties was reviewed for propriety. We found that the costs

attributed to the six properties were substantially ineligible or unsupported for funding. Accordingly, in our 1999 draft findings, we considered \$53,900 to be ineligible and \$220,708.33 to be unsupported.

Other costs associated with rehabilitation activities are ineligible (\$53,900) and unsupported (\$208,708.33)

As a result of our subsequent review of the six properties, we concluded that \$53,900 should be considered ineligible and \$208,708.33 should be considered unsupported. The details are as follows:

#### Property A and B, Ineligible Costs \$53,900

In 1994 and 1995, the Grantee made three loans totaling \$53,900 to an owner to rehabilitate the adjacent properties. Our review disclosed deficiencies related to the loans and rehabilitation work that render the costs ineligible. The deficiencies are as follows:

- In 1996, the Grantee was advised by a subrecipient that an inspection of Property A did not show evidence of rehabilitation work. The files supporting the rehabilitation work could not be located.
- Property B was not owned by the loan recipient and the documentation for the rehabilitation work could not be provided for review.
- The properties were demolished by the Grantee shortly after the purported rehabilitation.
- Loan payments were not made by the owner nor was there evidence that the Grantee ever sought collection of the loan. More significantly, the Grantee's loan receivable register did not include the loans pertaining to the properties.

#### Property C, Unsupported Costs \$92,589.93

In 1995, the program was charged with \$92,589.93 for rehabilitation work on a property that was demolished within months of the purported rehabilitation. We are contesting the costs because we believe the expenditure of funds represents an uneconomical and unreasonable use of program funds

and; therefore, does not meet the objectives of the CDBG program. Moreover, the documentation supporting the work performed was not adequate to assure that the costs were properly procured and monitored.

Property D, Unsupported Costs \$54,750

We are questioning the reasonableness of program charges for the following reasons:

- The loan documentation shows that in 1997, two loans were made to the owner on the same date. Although there appears to be two separate loan agreements, we found that the same signature page was used for both agreements.
- The loans were not recorded on the Grantee's receivable records and the Grantee did not receive any of the required loan repayments.
- Other than the copies of the loan agreements, no other supporting documentation was provided to justify the loan. Therefore, we were unable to assure that the costs were reasonable, that rehabilitation work was actually performed, or that the owner provided the corresponding equity investment of \$54,750.

Property E, Unsupported Costs \$61,368.40

The owner of this property received \$64,920 for rehabilitation work in 1995 and 1996. Our review of the program files disclosed that the files did not contain sufficient documentation to make a determination as to the reasonableness or propriety of the costs. In addition, the files did not include documentation showing that the owner contributed the required equity of \$16,230.

More importantly, our review found that the owner has not made any payments on the outstanding loan since August 1996, after making only five monthly repayments. The long-term delinquency occurred despite the fact that the owner received Section 8 subsidy payments for a tenant at the property. Accordingly, the remainder of the outstanding program funds amounting to \$61,368.40 is considered unsupported.

## Property F

In 1997, the Grantee provided \$12,000 to rehabilitate a three unit residence. Based on documentation provided by the Grantee subsequent to our 1999 draft finding, and since repayments on the loan are current, we are no longer questioning the costs associated with the loan.

However, our review of Grantee documentation relating to the loan showed weaknesses in controls over loan procedures and processing that warrant corrective action. Specifically, we found that the Grantee allowed the loan recipient to use receipts for costs incurred in 1995 and 1996 to meet the required equity contributions for the loan even though loan application and approval occurred in 1997. This practice not only complicates verification of the expenditures for authenticity, but raises concerns as to the reasonableness of the Grantee's award process for loans. In particular, allowing equity matches from periods prior to loan application could create an appearance of preferential treatment or favoritism in the Grantee's process of awarding loans.

The deficiencies described above are contrary to the regulations of the CDBG program, as well as, OMB Circular A-87. Because of the deficiencies, program funds have been used in an improper manner and the Grantee's ability to achieve required program objectives has been adversely affected.

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## Auditee Comments

The Grantee requests that sentencing for the former Grantee employee be allowed to occur prior to a determination that the city must repay funds.

The Grantee intends to undertake appropriate steps to secure available information, subsequent to identification of the universe of loans in question, to detail costs totaling \$208,708 against those projects at property addresses identified as part of the audit. For Property C, the Grantee contends that the rehabilitation costs incurred were eligible for funding.

The complete text of the Grantee's comments regarding Finding 2 is contained in Appendix C of this memorandum.

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## OIG Evaluation of Auditee Comments

Regarding the ineligible costs associated with for the former Grantee employee, the Grantee's CDBG program must be reimbursed for the loss. The reimbursement can come from the Grantee or the former employee. The Grantee must coordinate the reimbursement with HUD..

Regarding the Grantee's comments on Property C, the issue raised in the finding is not the eligibility of rehabilitation costs associated with Property C; but, the fact that the property was demolished within months of the purported rehabilitation work. Thus, we believe that the costs associated with the rehabilitation work is questionable.

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## Recommendations

We recommend that you require the Grantee to:

- 2A. Reimburse the ineligible costs totaling \$167,867 (\$113,967 plus \$53,900) to the CDBG program from non-Federal funds.
- 2B. Provide all available information on the unsupported costs amounting to \$208,708.33, so that our office can make all eligibility determinations.
- 2C. Reimburse the programs for any of the unsupported costs found to be ineligible.
- 2D. Implement corrective actions to provide assurance that the proper controls exist regarding the approval, disbursement, and collection of funds related to the rehabilitation activities administered by the Grantee.

### **Finding 3 - Grantee Did Not Adequately Administer or Monitor Program Activities**

The Grantee did not implement adequate controls to ensure that HUD program activities, including those administered by subrecipients, complied with applicable HUD regulations. Consequently, the Grantee could not adequately demonstrate that HUD funds amounting to almost \$832,000 were used for eligible and necessary activities, or that all HUD funded activities achieved appropriate program objectives. We believe that the Grantee did not adequately administer or monitor its activities because emphasis was not placed on establishing procedures that required compliance with HUD requirements.

#### Background

In our 1999 draft audit findings, we mentioned that the Grantee did not have assurance that HUD funds amounting to over \$781,000 were used for eligible costs. As part of our 1999 draft findings, we reviewed two activities administered directly by the Grantee: the Bankers Trust Economic Development Activity<sup>1</sup>; and, a contract awarded to Sutton Companies regarding monitoring of the Grantee's HOME Program. In addition, we examined the program files for three subrecipients participating in HUD programs during the review period: Utica Community Action, Inc.; Grow West, Inc.; and, Utica Neighborhood Housing Services. In our subsequent review of these activities, we concluded that HUD funds amounting to almost \$832,000 are questionable pertaining to the above mentioned activities. The details are as follow.

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

#### Review Results

As a result of our reviews, we concluded that deficiencies existed relating to the performance of the Grantee and its subrecipients regarding the administration of HUD funded programs and activities. For instance, we found that the

<sup>1</sup> Currently called the Adirondack Bank Building.



Grantee's files did not always contain all of the required documentation necessary to support program costs and the eligibility of activities. In addition, we identified financial control weaknesses that has led to the improper and questionable use of program funds. Details pertaining to the more significant weaknesses are discussed separately by activity and/or subrecipient below:

### **Bankers Trust Economic Development Activity**

Economic Development Activity, Unsupported Costs of \$646,153.17

The Grantee expended at least \$646,153.17 for the benefit of a private for-profit developer, without ensuring that the economic development activity complied with HUD regulations or their own Economic Development Guidelines. Consequently, we are unable to determine whether the activity was appropriate or meets a CDBG program objective. In addition, we found various deficiencies involving procurement, contracting, and supporting documentation for costs incurred. We consider the \$646,153.17 to be unsupported costs pending a HUD eligibility determination.

Background

In August 1996, the Grantee began using CDBG funds to make various improvements and repairs to the Bankers Trust Building. Even though the property was owned by the City's Urban Renewal Agency (URA), these improvements were an economic development activity for the benefit of a private for-profit developer. By the time the property was officially conveyed to the developer and the local Industrial Development Agency on May 1 1998, the Grantee had expended at least \$646,153.17 on improvements. Despite the large expenditure, the Grantee sold the building to the developer for \$1, and did not require any repayment of the improvements from the developer.

Criteria

Title 24, CFR Part 570.209 prescribes underwriting guidelines for Grantees to evaluate and select economic development projects. The objectives of the underwriting guidelines are to ensure that: (1) project costs are reasonable; (2) all sources of project financing are committed; (3) CDBG funds are not substituted for non-Federal financial support; (4) the project is financially feasible; (5) the return on the owner's equity investment will not be unreasonably high; and, (6) CDBG funds are

disbursed on a pro rata basis with other finances provided to the project.

The Grantee also established their own Economic Reinvestment Program guidelines that incorporate some of the above cited HUD guidelines.

Special consideration may have been afforded the developer

Despite the above criteria, the Grantee did not perform any underwriting or other financial analysis of the project. Therefore, the Grantee does not have adequate assurance that underwriting objectives were achieved. Moreover, several facts indicate that the Grantee may have afforded the developer special consideration. These facts are as follows:

- The Grantee could not provide a written agreement between the Grantee agencies involved and the developer regarding the federal CDBG funding. Consequently, the developer was never officially obligated to comply with requirements such as: (1) the level of equity investment and Grantee's ability to verify the equity; (2) how the activity meets a national objective; (3) how the Grantee will verify the number of jobs created; (4) how the Grantee will determine the amount of federal assistance needed; and (5) if federal assistance represents an unreasonably high return of owners equity.
- The building was sold to the developer for \$1, shortly after the Grantee expended the \$646,153.17 to improve the property. The Grantee could not provide evidence that any competing developers were offered the improved building for \$1.
- A financial analysis was not performed to determine if the cash flows of the project could afford repayment of a loan by the Grantee to the developer.
- File memorandums indicate that the developer was allowed to request that the Grantee perform certain work items as early as August 1996,

using CDBG funds. The URA did not officially select the developer until October 1996. The URA's minutes indicate that the title would pass to the developer in about a month from January 1997, but the title was not transferred until May 1998, after the Grantee had expended \$646,153.17 of CDBG funds to pay for the various improvements.

- The URA's minutes indicate that the developer was allowed to lease the building to tenants since October 1996, even though URA continued to own the building and make repairs with CDBG funds until May 1998. The Grantee could not provide evidence that repayment of CDBG funds was requested from the developer. Therefore, the developer enjoyed full ownership benefits of the property, while the Grantee continued to pay for repairs and improvements using CDBG funds.
- The developer continues to own and lease the property while not being liable to the Grantee for any financial or national objective obligations.

The Grantee had responded to our 1999 draft findings by stating that the Builders Trust activity could be construed as an elimination of slum and blight. In our opinion, the activity may not qualify as a slum and blight activity for the following reasons:

- The Grantee charged the activity's costs to their Economic Reinvestment Program, a Revolving Loan Fund for Economic Development. This program requires the Grantee to conduct extensive underwriting of a project. The Grantee could not provide evidence of any underwriting analysis.
- The developer requested that the Grantee perform certain work items as early as August 1996, the time period when CDBG funded improvements began. In our opinion, this indicates that the work was for the benefit of the developer, and not for the elimination of a slum and blight purpose.

- Much of the work conducted was for items that may not constitute structural or emergency repair normally associated with slum and blight activities. For example, over \$85,000 was spent on building "clean up" and over \$124,000 was expended on elevator repairs.

The Grantee's failure to follow HUD or local underwriting guidelines for this project precluded an appropriate determination as to the level or type of federal assistance needed for the activity. The Grantee could not provide any analysis to determine if the developer's revenues and cash flows were sufficient to amortize the \$646,153.17 of improvements as a loan. Moreover, evidence exists that the developer was generating lease revenue as early as October 1996, while requesting that certain work items be performed by the Grantee. Also, the developer was not required to provide any evidence of owner's equity or job creation goals. Accordingly, we are requesting that HUD make an eligibility determination on the Grantee's use of the \$646,153.17.

\$9,000 Unsupported costs

#### **Sutton Companies (HOME Contract)**

In July 1995, the Grantee entered into an agreement with the Sutton Companies to review its HOME program. The contract services were complete in December 1995, with \$9,000 of the maximum contract amount of \$9,500 being paid to the contractor.

Our 1999 draft findings showed that the Grantee could not document that the costs were reasonable and necessary to carry out their programs. We found that the scope of services to be provided by the contractor was vague and that the Grantee was unable to provide the final report for our review. Accordingly, the \$9,000 was considered an unsupported cost.

In our subsequent review, we again asked for the final report. The Grantee was still unable to provide the final report for our review. Consequently, the \$9,000 remains unsupported pending a HUD determination.

Criteria

Title 24, 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.

**Utica Community Action, Inc. (UCAI)**

\$176,500 Unsupported costs

The Grantee awarded UCAI HOME funds as part of a project known as Operation Restore. The funds were awarded so that UCAI could purchase numerous parcels of City owned land from the URA to facilitate their development plans. The 1999 draft findings questioned \$176,500 because of weaknesses in the Operation Restore development plans. Our current review noted that UCAI appears to be fulfilling their role as developer as some progress has been made and UCAI recently combined their Operation Restore efforts with the City of Utica and Utica Housing Authority's HOPE VI application.

Notwithstanding the above, a more important issue may be the necessity and reasonableness of the costs. While we recognize that acquisition is an eligible HOME activity, we noted that the \$176,500 was primarily a transfer of federal funds from the HOME program to the City's URA. The City owned the parcels (through the URA) and could have simply transferred the title to the UCAI for development purposes. Moreover, we noted that the costs included a developer fee of \$30,000 paid to UCAI and a fee of \$20,000 paid to URA. There was not adequate supporting documentation for either fees or an explanation as to why the fees were necessary.

Accordingly, we consider the \$176,500 as unsupported costs and are requesting that HUD make an eligibility determination as to the necessity and reasonableness of the costs.

**Grow West, Inc.**

Our 1999 draft findings regarding the subrecipient files maintained by the Grantee and our site visit to the subrecipient found several administrative and financial

weaknesses. The more significant matters are outlined below:

- Documentation supporting costs claimed were inadequately supported. Examples include invoices that did not contain adequate information detailing the costs; amounts on invoices did not always agree with check amounts, and invoices that were not marked cancelled when actually paid.
- Weaknesses regarding the procurement services were found. The weaknesses include: no evidence of ranking and rating of proposals; missing contract documents; contracts documents that lacked necessary information; and, a potential conflict of interest associated with the awarding of one contract.

As explained below our subsequent follow up review indicated that the Grantee has improved its monitoring of this subrecipient.

### **Utica Neighborhood Housing Services**

Our initial 1999 draft findings indicated that the activities administered by this subrecipient showed the following weaknesses:

- The Grantee reimbursed the subrecipient for costs incurred prior to the Notice to Proceed. This violates the contract for services executed with the Grantee.
- Supporting documentation was not always adequate enough to make eligibility determinations regarding payments to the subrecipient for costs claimed.
- Budget amounts contained in the contract with the subrecipient were not detailed enough to adequately control and monitor the use of funds. For example, payroll costs were not detailed by employee, position, or salary proration.
- Weaknesses in budget controls may have resulted in CDBG funds being used to pay a disproportionate

amount of the subrecipient's general operating expenses. For example, in the period between April and June 1996, CDBG funds were paid to reimburse the subrecipient for 72 percent of its general operating costs for the period.

Subsequent to our 1999 review the Grantee established firmer controls over its monitoring efforts of the CDBG activities administered by subrecipients, Grow West and Utica Neighborhood Housing. Moreover, the Grantee contends that these two subrecipients are generally complying with the Grantees requirements regarding subcontract administration and supporting documentation for costs. We commend the Grantee for their efforts in this regard, but must remind the City that the draft issues raised during our 1999 review, as detailed above, need to be addressed.

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**Auditee Comments**

Although the Grantee acknowledges that it did not follow prescribed underwriting guidelines required by Title 24, CFR Part 570.209 when approving and funding the Banker's Trust project, the Grantee contends that the activity was of an eligible type. The Grantee further contends that the activity achieved the National Objective of creating low/moderate jobs. As such, the Grantee believes the costs incurred for the activity should be deemed eligible.

The complete text of the Grantee's comments regarding Finding 3 is contained in Appendix C of this memorandum.

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**OIG Evaluation of Auditee Comments**

The Grantee response acknowledges that it did not follow prescribed underwriting guidelines required by Title 24, CFR Part 570.209 when approving and funding the Banker's Trust project.

The audit finding discusses how the lack of underwriting precluded an appropriate determination as to the level or type of federal assistance needed for this activity. The Grantee response does not address the underwriting issues raised in the finding. For example, the Grantee requests that the \$646,153.17 of federal assistance be deemed eligible. The Grantee bases this request on the assertion that low/moderate jobs were created. While Title 24, CFR Part 570.203 (b) allows for assistance to developers for the

purpose of job creation, this does not change the fact that no underwriting rules were considered when “awarding” the developer funding.

Accordingly, we are asking HUD to render an eligibility determination based upon the facts presented in the finding.

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## Recommendations

We recommend that you:

- 3A. Determine the eligibility of the unsupported costs of \$646,153.17 pertaining to the Bankers Trust economic development project.
- 3B. Determine the eligibility of the \$9,000 paid to Sutton Companies for the review of the HOME program.
- 3C. Determine the eligibility of the \$176,500 of HOME funds awarded to UCAI for the purchase of City owned land.
- 3D. Instruct the Grantee to reimburse the CDBG program from non-Federal funds for any amounts that you determine to be ineligible.
- 3E. Instruct the Grantee to implement procedures to ensure that all Economic Development activities comply with Federal regulations and local requirements.
- 3F. Instruct the Grantee to continue their efforts to monitor program activities as required by Title 24, CFR Part 85. The monitoring should ensure that the financial management systems of subrecipients are in compliance with program regulations and that program goals are being achieved.



## **Finding 4 - Section 8 Administrative Contract Was Not Controlled Effectively**

Besides CDBG, the Grantee administers a Section 8 Housing Assistance Program. On March 20, 1997, the Grantee contracted with Utica Community Action, Inc. (UCAI) to administer its Section 8 Program. During the ensuing eleven months ending February 19, 1998, the Grantee did not effectively scrutinize UCAI's performance to ensure that UCAI administered the program in accordance with the established Administrative Plan and Section 8 regulations. Consequently, UCAI expended at least \$127,352 for costs that were not adequately documented. We believe the cited deficiencies occurred because the Grantee did not effectively monitor UCAI's performance to ensure compliance with the Section 8 administrative plan.

### Background

In our 1999 draft audit findings, we mentioned that UCAI expended at least \$127,352 in unapproved and inadequately documented costs and had not returned \$43,234 in Section 8 funds to the Grantee. Our subsequent follow up on these issues disclosed that UCAI expended at least \$127,352 for costs that are inadequately documented. Also, after our inquiries, in September 2001, UCAI returned the \$43,234 to the Grantee. The details of our review are as follows:

In March 1997, the City of Utica, New York entered into an agreement with UCAI to administer its Section 8 Program. The agreement provided that UCAI would administer the program in accordance with the provisions of the administrative plan, equal opportunity plan and Section 8 regulations. The agreement covered the term from March 1997 through December 31, 1999. However, in February 1998, pursuant to a decision and order of a New York State Administrative Law Judge, the Grantee was required to restore the administration of the program with the City.

Our decision to review the matter was based on our initial survey work that included review of an IPA report commissioned by the Grantee to evaluate UCAI's administration of the Section 8 Program. The report obtained questioned costs and evidence of a scope impairment caused by UCAI's reluctance to permit the accountant to review its administrative costs.

### Scope of Review

The scope of our review included an examination of the accountant's report and supporting audit work papers. In addition, we reviewed the administrative agreement executed

## Deficiencies noted

by the Grantee and UCAI, as well as other documentation maintained by the Grantee.

We believe the Grantee's lack of contract oversight limited assurance that the Section 8 Program was being properly administered and permitted the deficiencies discussed in the following subsections to remain undetected.

### UCAI Has Incurred Inadequately Documented and Unapproved Costs

Despite the provisions of the Section 8 Administrative Plan requiring Grantee approval of all expenditures from the operating reserve in excess of the annual ongoing administrative fee, UCAI expended a net amount of \$127,352 without the required approval. Moreover, the IPA report questioned the costs because they were not adequately documented.

Subsequent to preparation of our 1999 draft findings, the Grantee requested and received documentation from UCAI regarding the unsupported net expenditures of \$127,352. Even though the Grantee obtained additional cost related documentation, our current review of the documentation showed it to be incomplete and/or inadequate, thus precluding us from making an eligibility determination. Particulars regarding the documentation weaknesses are contained in Appendix A of this report.

### Use of Section 8 Funds for Capital Acquisition Costs

Section E of the Program Agreement provides that assets purchased with Section 8 funds in excess of \$1,000 shall be returned or other compensation made to the Grantee when the property is no longer needed in the project or program for which it was purchased. Our review showed that included in the \$127,352 of unsupported costs (Appendix A) was \$91,070 incurred primarily for soft costs associated with the purchase of real estate. Consequently, a HUD determination is necessary to establish if and how such capital assets should be controlled.

Excess Section 8 Funds

Our review of the IPA's report and supporting documentation showed that UCAI collected from the Grantee \$43,234 more in Section 8 funds than it had expended. The provisions of the agreement entered into with UCAI clearly warranted the return of the funds. Despite the requirement, the excess funds were not returned to the Grantee until September 2001, subsequent to the time that we had advised the Grantee that the draw of excess funds would remain a reportable condition. Consequently, a cost efficiency of \$43,234 has been recognized.

Corrective Actions are Needed

The matters discussed in this finding constitute non-compliance regarding the agreement executed with UCAI. Moreover, the deficiencies cited indicate a general lack of control and effective oversight by the Grantee with regard to contractor performance of its HUD funded Section 8 Program. Consequently, it is imperative that immediate corrective actions be undertaken to resolve the questioned costs and disposition of assets issues raised in the finding.

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Auditee Comments

The Grantee generally agreed with the issues raised in the finding.

The complete text of the Grantee's comments regarding Finding 4 is contained in Appendix C of this memorandum.

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OIG Evaluation of Auditee Comments

The Grantee's comments indicate that they will institute corrective actions pertaining to the recommendations in this finding.

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Recommendations

We recommend that you require the Grantee to:

- 4A. Require UCAI to provide complete and conclusive documentation in support of the \$127,352 in questioned costs.

- 4B. Require UCAI to reimburse the Grantee for any costs determined to be ineligible including costs that cannot be adequately documented.

Additionally, we recommend that you:

- 4C. Advise the Grantee of your determinations regarding the disposition of assets purchased with Section 8 operating reserve funds.

## Section 8 Contract Monitoring Analysis

### Analysis of Operating Reserve

Source: Dermody, Burke & Brown – Independent Accountants’ Report Dated March 26, 1998.

Gross Amounts transferred out of operating reserve	\$159,694
Amount reimbursed to operating reserve	<u>(\$32,342)</u>
Net Amount transferred out of operating reserve	<u><b>\$127,352</b></u>

### IPA Identified Cash Outflow Transactions and OIG Analysis of Grantee Cost Documentation

<u>Date</u>	<u>Amount</u>	<u>Capital Costs</u>	<u>Description</u>	<u>Notes</u>
8/15/97	\$ 3,710		Computer Software	1
8/25/97	5,876		Start-up Costs	1
8/29/97	30,000	\$30,000	Hygeia (Environmental Testing)	2,3,5
8/29/97	5,000	5,000	land Acquisition Costs	3
9/11/97	1,350	1,350	Environmental Testing	1,3
9/12/97	20,000	20,000	Environmental Testing	2,3,5
11/12/97	20,000	20,000	Environmental Testing	3,4,5
11/18/97	1,700	1,700	Legal Fees	3,5
11/18/97	13,020	13,020	Allied American Abstract – Title Work	3,6
1/20/98	20,000		Security for Housing	7
1/15/98	5,329		Escrow for Self-Reliance Program	1
2/1998	1,380		Additional Security Payment	7
2/1998	32,342		Subsidy Payment – Housing Related	1
	(13)		Excess Credit for Returned Bid Deposit	8
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	\$159,694	\$91,070	Total	
	=====	=====		

#### Notes

- 1 The Grantee provided no supporting documentation for the cost. As such, the cost is unsupported.
- 2 Supporting documentation is not descriptive; it does not identify the properties tested, when the properties were tested, or what the results of the testing were.
- 3 Section E of the Program Agreement between the Grantee and UCAI provides: assets purchased with Section 8 funds in excess of \$1,000 shall be returned or other compensation made to the Grantee when the property is no longer needed in the project or program for which it was purchased. The cost is unsupported pending a HUD determination regarding the disposition and control over capital assets purchased with Section 8 operating reserve funds.
- 4 Payment of \$18,400 exceeds invoiced amount by \$400. The check copy included in the supporting documentation for \$18,400 was not a cancelled check. Moreover, the supporting documentation is not descriptive; it does not identify when the properties were tested, or what the results of the testing were. Also, the invoice documented in the file is dated 11/4/97 even though the check was dated 10/17/97. A second payment for \$1,600 on 10/17/97 did not evidence the applicable properties, the date work was performed, or the results of the testing performed.
- 5 Supporting documentation did not contain evidence of a contract, nor did the documentation detail or verify that proper procurement procedures were followed.

- 6 Represents payment to the contractor's attorney for a third party billing. Although the documentation evidences payment made by the contractor to its attorney, it does not evidence that payment was made to the third party vendor.
- 7 Documentation regarding contract procurement must be reviewed for propriety before an eligibility determination can be made.
- 8 No deficiency noted.

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**SCHEULDE OF INELIGIBLE AND UNSUPPORTED COSTS AND COSTS EFFICIENCIES**

<b>Findings No.</b>	<b><u>Ineligible Costs (1)</u></b>	<b><u>Unsupported Costs (2)</u></b>	<b><u>Cost Efficiency (3)</u></b>
<b>2</b>	\$167,867.00	\$208,708.33	
<b>3</b>		831,653.17	
<b>4</b>		127,352.00	\$43,234.00
<b>TOTALS</b>	<b><u>\$167,867.00</u></b>	<b><u>\$1,167,713.50</u></b>	<b><u>\$43,234.00</u></b>

- (1) Ineligible costs are costs charged to a HUD-financed or insured program or activity that the auditor believes 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 the 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. The decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.
- (3) A cost efficiency is an action by management in response to the Inspector General's recommendations to prevent improper obligation or expenditure of funds or to avoid further unnecessary expenditures.

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GRANTEE COMMENTS



**CITY OF UTICA**

URBAN & ECONOMIC DEVELOPMENT

1 Kennedy Plaza, Utica New York, 13502

315-792-0181 fax: 315-797-6607

TIMOTHY J. JULIAN

MAYOR

MARK F. MOJAVE

Commissioner

October 30, 2001

Mr. Alexander C. Malloy

District Inspector General for Audit

US. Department of Housing & Urban Development Office of Inspector General

26 Federal Plaza Room 3430 New York, New York 10278 0068

RE: City of Utica Draft CDBG Program Audit

Dear Mr. Malloy:

This letter is in response to the four tentative audit findings developed as part of the original 1999 draft audit, and revisited during this past summer, relating to the City of Utica's prior use of various Housing & Urban Development (HUD) programmatic funds.

We thank you for yours and your staffs time spent in bringing closure to these issues dating back several years ago. We are hopeful that you will consider the comments contained herein in the spirit of moving forward in ensuring that federal dollars are put to the best use while being mindful of programmatic requirements.

Sincerely,

Mark F. Mojave

Commissioner

Cc: Mayor Tim Julian

James Sahlager, Finance Administrator



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Draft Finding 1

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**Recommendation 1A**

With regards to those items you have qualified as deficiencies as part of Draft Finding 1A, the following written response is offered:

The first component of Finding 1 states that "management control weaknesses still exist" based upon the specific finding that "the Grantee lacks adequate fidelity bond coverage." It should be noted that as of January 2000 the Department of Urban & Economic Development made the administrative decision that the Economic Reinvestment Program (ERP) payments in particular would be collected by the Comptroller's office directly. This Program comprises the largest volume of activity, as well as the largest cumulative dollar amount. Accordingly, the value of cash receipts currently handled annually by Department of Urban & Economic Development financial staff is approximately twenty percent (20%) of what it was prior to the Comptroller's office receiving ERP payments directly. Please find attached a current City of Utica Fidelity Bond Coverage schedule. The schedule coverage for the Finance Administrator within the Department of Urban & Economic Development, listed at \$175,000, is currently more than two times the amount of cash receipts handled annually against the Rental Rehab program. Accordingly, fidelity bond coverage currently exceeds operational requirements.

The second component of Finding 1 states that "subsidiary records are not reconciled to the general ledger in a timely manner". Please find included as an attachment to this document a departmental ERP reconciliation, the same that has been forwarded to the Comptroller's office. It is against this list from the Department's Economic Reinvestment Program (ERP) for payments received to date (10/26/01) for the month of October that the Comptroller's office will make adjusting entries to reconcile the City's general ledger. The reconciliation occurs monthly subject to closeout for cash receipts for that particular month. An October reconciliation against the city's general ledger would be available five (5) business days after month end. It should be noted that the Comptroller's office has a staff person dedicated to the monthly task of reconciling the city's general ledger to the Department of Urban & Economic Development's accounting of ERP loans.

Lastly, concerning the observation that "cash receipts are collected by various City Departments instead of exclusively collected by the Comptroller's Office", it was our understanding that the scope of the Inspector General's audit was within the framework of the Department of Urban & Economic Development's activities concerning the administration of Community Development Block Grant (CDBG) funds. Regardless of this fact, it should be noted that the City of Utica is a medium sized city. Like many other medium-sized cities, Utica has made the administrative decision so as to allow the City Clerk's office to collect Marriage License fees, the City Codes Department to collect provided which provides an exact schedule of coverage by position for these cash receipts functions.

In summary, Finding 1 is flawed, based upon the scope of this draft audit, as to the position that "deficiencies still exist and corrective actions are needed." Accordingly, we respectfully request that this section be amended to reflect adequate standards that have been implemented to safeguard the use and administration of federal dollars.

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### **Draft Finding 2**

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#### **Recommendation 2A**

We would respectfully request that sentencing for the former Grantee employee be allowed to occur prior to a determination that the city must repay funds. Specifically, we would like to await judicial determination of appropriate restitution, if any, of the amount embezzled, \$113,967. If, in fact, restitution in that amount to the City of Utica is not to occur as a condition of sentencing, then the City would review its' rights under the law in seeking restitution.

#### **Recommendation 2B**

With regards Finding 2B, it is our intention to undertake appropriate steps to secure available information, subsequent to identification of the universe of loans in question, to detail costs totaling \$208,708 against those projects at property addresses identified as part of the audit.

With regards to Property C in particular, it should be noted that the expenditure of funds occurred within a targeted urban area under the direction of one administration. Upon a change in administration, with then newly elected Mayor Hanna re-establishing urban development priorities, it was decided that Property C no longer played a key role in re-establishing this portion of the city's core urban neighborhood. It was further decided that property C in fact inhibited implementation of a newly established economic development initiative. The decision was subsequently made to demolish Property C. In summary, at the time of investment of \$92,589.93 in CDBG dollars, the project could be demonstrated to have met eligibility criteria. In addition, costs were appropriate for the level and type of work necessary to stabilize the commercial property in question with required procurement procedures adhered to. Accordingly, regardless of this administration's or your own agency's opinion as to the wisdom of the decision made to tear down Property C, we would respectfully request that our citizenry not be penalized for decisions made in accordance with shifting priorities under the Hanna administration and that the expenditure be determined to be eligible.

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Draft Finding 3

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**Recommendation 3A**

Finding 3A speaks to inadequate administration and monitoring of program activities relating to what is known as the Banker's Trust Building Project. The city acknowledges that, dating back to August of 1996, then prescribed underwriting guidelines, as referenced in Title 24, CFR Part 570.209, were not strictly adhered to by the city, nor its agencies, in making an eligibility determination for this project.

However, it must be stated the Banker's Trust project, prior to identification of a developer, did qualify as an eligible activity under CFR Part 570.203 (a), whereby eligibility includes "commercial or industrial improvements carried out by the grantee or a nonprofit sub-recipient, including: acquisition, construction, rehabilitation and installation of real property equipment and improvements" which began in August 1996. Subsequent to identification of a potential developer and conveyance of ownership interest on May 1, 1998 the project would again qualify as an Eligible Activity in accordance with CFR Part 570.203 (b) that allows for "assistance to private for-profit entities for an activity determined by the grantee to be appropriate to carry out an economic development project. This assistance may include: grants, loans or technical assistance." In addition, that assistance offered was made in furtherance of a National Objective, that being the creation of Low/Moderate Jobs listed outlined as a criteria in CFR Part 570.208 (a)(4).

Accordingly, in keeping with the national standard of one Low/Mod job to be created for every \$35,000 in CDBG dollars provided against a total of \$646,153.17 expended for this project, the city shall provide documentation of low/mod jobs created, with a pre-established goal of 18.5. Included as an attachment to this letter are two job monitoring reports from Mr. Harold T. Clark, President of Adron LLC. The first document, dated May 14, 1998, certifies that there are 14 new hires, with 9 of those qualifying as Low/Mod. The second document, dated October 16, 2001, certifies 47 new hires with 25 of those qualified as Low/Mod. Additional supporting documentation will be provided for review and approval. Accordingly, we request that these costs of \$646,153.17 be deemed eligible.

**Recommendation 3B**

A final report of the Sutton Companies HOME Contract has been secured and is being forwarded to the HUD area office as supporting documentation to this response. Accordingly, we would request that these costs of \$9,000 be deemed eligible as an administrative charge to the HOME program from which the funds were paid.

**Recommendation 3C**

The Department of Urban & Economic Development has requested additional supporting documentation against a \$30,000 developer's fee paid to UCAI and a \$20,000 developer's fee paid to URA. Upon receipt of the same, it shall be forwarded for review in order to determine eligibility.

**Recommendation 3D**

Reimbursement from non-federal funds for amounts determined to be ineligible shall be made.

**Recommendation 3E**

In support of implementing procedures to ensure that all Economic Development activities comply with federal regulations and local requirements, please find attached the City of Utica, Department of Urban & Economic Development's Policies and Procedures Manual, effective as of September 2001. The attached manual has been developed in concert with the active oversight and input of the HUD area office in Buffalo.

**Recommendation 3F**

In support of programmatic monitoring activities of sub-recipients, as required by Title 24, CFR Part 35, please find attached a memo from the Departmental Grants Administrator referencing a schedule for financial on-site monitoring based upon annual benefit received. Also included is the city's draft "Guidelines for Sub-recipient Monitoring" that will be implemented upon final approval by the HUD area office. Please bear in mind that this methodology for sub-recipient monitoring was derived with the active support and oversight of HUD Buffalo.

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**Draft Finding 4**

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**Recommendation 4A**

The city received reimbursement of the \$43,234 held by UCAI on September 4, 2001 (copy attached).

**Recommendation 4B**

UCAI has been required to provide complete and conclusive documentation in support of the \$127,352 in questioned costs.

**Recommendation 4C**

UCAI shall be required to reimburse the City of Utica for any costs determined to be ineligible including costs that cannot be adequately documented.

**Recommendation 4D**

Please advise as to the determination regarding the disposition of assets purchased with Section 8 operating reserve funds and the city will act accordingly.

**Distribution**

Commissioner, City of Utica, Department of Urban & Economic Development, Utica, New York  
The Honorable Mayor, City of Utica, Utica, New York  
Principal Staff  
(Acting) Secretary's Representative, New York./New Jersey, 2AS  
Director, Community Planning and Development, 2CD, Buffalo Area Office,  
Senior Community Builder, Buffalo Office, 2CS  
Assistant General Counsel, New York/New Jersey, 2AC  
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Office of the Deputy Assistant Secretary for Grant Programs, (Attn: Special Advisor/Comptroller  
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The Honorable Joseph Lieberman  
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