



**MEMORANDUM NO:
2002-SF-1804**

July 31, 2002

MEMORANDUM FOR: Steven B. Sachs
Director of Community Planning and Development, 9AD

FROM: //SIGNED//
Mimi Y. Lee
Regional Inspector General for Audit, 9AGA

SUBJECT: HOME Investment Partnerships Program
City of Stockton, CA
San Joaquin County, CA
Asociacion Campensina Lazaro Cardenas Inc. (ACLC)
Stocktonians Taking Action to Neutralize Drugs (STAND)

INTRODUCTION

We have completed an internal audit survey of the HOME Investment Partnerships Program (HOME). The purposes of the survey were to evaluate the susceptibility of HOME to unnecessary risk of waste, fraud or abuse and to determine the need for and direction of any additional internal audit coverage. As part of the internal audit survey, we completed some limited external audit survey work at the two subject Participating Jurisdictions (PJs) and the two subject Community Housing Development Organizations (CHDOs).

This memorandum communicates our review results and recommendations pertaining to the external PJs and CHDOs. We will provide a separate Memorandum to the Deputy Assistant Secretary for Grant Programs with internal recommendations addressing several departmental and programmatic issues, but we do not believe additional internal audit coverage is warranted at this time.

BACKGROUND

The HOME Program is authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act of 1990 as amended, and implementing Regulations are specified at 24 CFR Part 92. HOME funding is allocated to eligible State and local governments to strengthen public-private partnerships and to expand the supply of decent, safe, sanitary, and affordable housing for very low-income and low-income families. State and local governments that become PJs may use HOME funds to carry out multi-year housing strategies through acquisition, rehabilitation, and new construction of housing, and tenant-based rental assistance. PJs may provide assistance in a number of eligible forms, including loans, advances, equity investments, interest subsidies and other forms of investment approved by HUD. HOME Regulations require that PJs reserve not less than 15 percent of their allocations for housing to be developed, sponsored, or owned by approved CHDOs. Private nonprofit, community-based service organizations receive their certification and designation as CHDOs from PJs based upon criteria specified in 24 CFR Part 92.

METHODOLOGY AND SCOPE

The scope and methodology of the audit survey work for the external audit entities included:

- Review of files and interviews of staff at the two PJs and two CHDOs.
- Interviews of homeowners and inspection of construction or rehabilitation work for eight¹ single family properties.
- Review of HUD real estate owned (REO) and FHA insured loan files as applicable for the eight single family properties.
- Review of five tenant files at one ACLC rehabilitated multifamily project and inspection of the units and interviews of tenants for three of the five.
- Research of possible undisclosed identities or conflicts of interest using various public records and Internet resources for numerous entities or individuals.

SURVEY RESULTS

Based upon the limited external audit survey work, the majority of HOME program operations and activities at both PJs and both CHDOs appear to be in accordance with statutory and regulatory requirements. However, our survey did identify some areas of apparent risk and several deviations from program requirements including: (1) weaknesses in PJ monitoring of subrecipients, (2) administrative weaknesses at both the PJ and subrecipient or CHDO level, and (3) actual or apparent conflicts of interest.

PJ Monitoring of Contractors and Subrecipients (CHDOs)

Regulations at 24 CFR 92.504 impose responsibility on PJs for ensuring that HOME funds are used in accordance with all program requirements and written agreements, and for taking

¹ Five ACLC properties and three STAND properties.

appropriate action when performance problems arise. The Regulations require PJs to review the performance of each contractor and subrecipient at least annually.

Although both of the PJs included in our survey did provide upfront and ongoing oversight of CHDO activities through initial project approval, review of funding requests, and periodic inspection of projects, neither PJ conducted actual monitoring of any overall CHDO operations. PJ review of funding requests did not always provide the intended oversight since there were instances where CHDOs received funding solely on the basis of their requests without any supporting documentation. Also, upfront oversight was less than effective in some cases such as the approval of CHDO operating cost funding without any demonstrated need for the funding.

PJ monitoring reviews of overall CHDO operations are necessary in part to ensure that HOME funding is provided only for reasonable, necessary, eligible expenditures and is not duplicative of funding from other Federal, State or local sources. They are also necessary for assessing the actual ongoing performance of the CHDOs. Since HUD is not involved in CHDO initial approvals and does not monitor CHDO operations, it is essential that PJs perform comprehensive annual reviews of their operations.

PJ Administrative Weaknesses

In addition to problems with subrecipient monitoring, we found other administrative weaknesses at both of the PJs included in our survey. Neither PJ was in compliance with OMB Circular A-87 relative to the allocation of some PJ administrative costs. Although the methods used appeared reasonable, they deviated from the OMB requirements.

City of Stockton employees do not maintain the required individual activity reports (time sheets) documenting the amount of time spent on HOME versus other activities. Rather, salary costs are allocated to HOME based on estimates by supervisors as to how much time staff spends working on the various programs.

Most San Joaquin County employees who work on HOME activities do maintain the required time sheets evidencing time spent on HOME versus other HUD and non-HUD funded activities. The exception is the accounting staff. The County accounting staff salaries are allocated between HOME and other HUD and non-HUD funded activities on the basis of estimated revenue from each source.

CHDO Administrative Weaknesses

Neither of the CHDOs we reviewed was in compliance with OMB Circular A-122 relative to the documentation or allocation of operating costs as required by their grant agreements with the PJs. Neither CHDO maintained personal activity reports for employees evidencing time spent on HOME versus other activities. STAND prepared time sheets only differentiating work time versus leave or holiday time, and ACLC prepared time sheets allocating work hours between different projects but some of the projects received funding from other sources in addition to HOME.

Neither CHDO maintained records demonstrating a need for operating cost funding. The CHDO requests for operating cost funds did not identify any funding shortfalls and in fact, pay raises and bonuses provided to principal staff suggest the operating cost funds were not needed. For example, the ACLC Chief Executive Officer received a 22.8 percent pay raise in March 1999 and an 18.4 percent bonus in December 2000. ACLC paid more money in staff bonuses in 2000 and 2001 than they received in operating cost funding during the period from the City of Stockton.

Neither CHDO maintained board meeting minutes evidencing important administrative or HOME related activities. ACLC maintained minutes which appear to reflect most HOME related activity but did not have documentation of board approval for staff raises and bonuses. STAND was unable to produce even informal minutes evidencing board involvement in any HOME related activity.

One of the CHDOs (STAND) used an unlicensed contractor for some rehabilitation work. Although this contractor normally did relatively small scope jobs at reasonable prices and apparently completed the work satisfactorily, a license was required for much of the work. Moreover, STAND's use of this unlicensed contractor leaves both STAND and homeowners with little recourse if problems should occur.

Actual or Apparent Conflicts of Interest

HOME program Regulations at 24 CFR 92.356 provide in part that “No persons ... who exercise any functions or responsibilities with respect to activities assisted with HOME funds or who are in a position to participate in a decision making process or gain inside information with regard to these activities, may obtain a financial interest or benefit from a HOME-assisted activity, or have an interest in any contract, subcontract or agreement with respect thereto, or the proceeds thereunder, either for themselves or those with whom they have family or business ties, during their tenure or for one year thereafter.”

ACLC appears to have violated these Regulations with an office lease agreement with a corporation partially owned by one of the ACLC board members, and with the award of HOME loan funds to an ACLC employee. The lease agreement has been disclosed in audited financial statements submitted to both PJs² who provide ACLC with HOME funding but no “exception”³ to the conflict of interest provisions in the Regulations has been obtained. The employee who received the HOME funded loan was otherwise eligible and does not appear to have received special consideration, but again the required exception was not obtained. ACLC also used HOME funds to purchase a property from a City of Stockton Community Development Committee member. Although not a clear violation of the Regulations, this transaction leaves an appearance of possible conflict of interest.

² City of Stockton and San Joaquin County.

³ An exceptions to the conflict of interest restriction may be granted on a case-by-case basis when it will serve to further the purposes of HOME and the effective and efficient administration of the PJ's program or project, (24 CFR 92.356(d)).

AUDITEE COMMENTS AND OIG EVALUATION

Both PJs and both CHDOs provided written responses to the draft report. The draft report and their responses were also discussed at an exit conference on May 28, 2002. The written and verbal comments provided are summarized below and we made changes to this final report where appropriate.

City of Stockton

The City took the position that no exception to the conflict of interest restrictions was necessary for the assistance provided to the ACLC employee, and the property purchased by ACLC from a member of the City's Community Development Committee did not represent either a real or apparent conflict of interest. Whereas we interpreted paragraphs (b), (c) and (d) of 24 CFR 92.356 as applicable to the ACLC employee loan, the City contends paragraph (f)(1) is applicable. We have requested a legal opinion on this issue in conjunction with the National memorandum report. Regardless of the legal opinion (as relates to the applicability of 24 CFR 92.356 conflict of interest restrictions to CHDOs in general), the original Loan and CHDO Agreement executed between the City of Stockton and ACLC in 1994, includes conflict of interest restrictions, which we believe prohibit each of the apparent conflicts. However, we have reworded the recommendation to include the possibility there may not actually be a conflict of interest with respect to any of the issues identified including the property purchased from the Community Development Committee member.

San Joaquin County

The County indicated annual monitoring of all of its CHDOs has taken place but also stated that documentation of the monitoring activity could be and will be improved. They also contend the one and only allocation of CHDO operating expense funds (to STAND) was necessary and clearly demonstrated. The County indicated the intention to comply with all of the draft recommendations applicable to their HOME program.

STAND

STAND expressed the definite necessity for the operating expense funding received from the County. They also said the missing board meeting minutes have been located and they have discontinued using the unlicensed contractor. STAND welcomed the assistance of HUD and/or the PJs in establishing procedures for allocating administrative and operating costs in accordance with OMB Circular A-122 and their grant agreement.

ACLC

ACLC's written response provided explanation and justification for each of the issues in the draft report applicable to their operations. Based on their response and accompanying documentation, we removed a section of the report dealing with low-income community representation. ACLC requested that we include a copy of their response in the final report in order for their

explanations to be heard and to include recognition of their record of serving the community. We made changes to the final report and recommendations where applicable, and have included ACLC's response as Attachment A.

RECOMMENDATIONS

We recommend that you:

- 1A. Require both PJs to prepare and submit schedules of planned comprehensive subrecipient and contractor monitoring reviews.
- 1B. Instruct the PJs to determine whether operating cost funding provided to the CHDOs was necessary and reasonable and recover any amounts that cannot be demonstrated as both necessary and reasonable.
- 1C. Instruct the PJs to establish acceptable documentation for CHDO and subrecipient payment requests.
- 1D. Assist the PJs in establishing procedures for allocating administrative costs to HOME which comply with OMB Circular A-87.
- 1E. Instruct the PJs to assist the CHDOs in establishing procedures for allocating operating costs to HOME, which comply with OMB Circular A-122 and the grant agreements.
- 1F. Instruct the PJs to require the CHDOs to maintain board meeting minutes evidencing all important administrative and HOME related activities.
- 1G. Instruct the PJs to verify that STAND has discontinued the use of the unlicensed contractor.
- 1H. Evaluate the actual or apparent conflicts of interest involving (a) the ACLC board member and the ACLC office lease agreement, (b) the ACLC employee HOME funded loan, and (c) the ACLC purchase of property from a City of Stockton Community Development Committee member and if conflicts are confirmed, either grant exceptions if allowable under the Regulations or provide appropriate direction to remedy the conflicts.

Within 60 days please provide us, for each recommendation in this report, a status report on: (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (415) 436-8101.

June 11, 2002

Ms. Mimi Y. Lee
District Inspector General for Audit
US Department of Housing and Development
Office of Inspector General
450 Golden Gate Avenue, Box 36003
San Francisco, CA 94102-3448



SUBJECT: Internal audit survey of the HOME Investment Partnership Programs

Dear Ms. Lee,

This letter will serve as response to the draft audit findings for ACLC, Inc.

• **CHDO Administrative Weaknesses**

ACLC maintains accurate time sheets reflecting hours worked on each ACLC project. In an effort to separate time spent on HOME versus other activities ACLC will cure this deficiency by adding a column to reflect HOME funded activities.

ACLC maintains annual budgets that are approved by the Board of Directors. The budget clearly demonstrates proposed revenue, expenses and their sources. Based on the budgets the Board approves these budgets and authorizes the CEO to run the agency and to compensate the employees of ACLC, Inc. The Board takes full responsibility for the compensation of the CEO. ACLC clearly demonstrates the need for HOME and all other funds in our annual budget. Staff receives bonus bases on project performance, this does not mean that that HOME funds are not needed however, compensation to employees only strengthens the agencies ability to produce. ACLC Board of Directors feels strongly that bonuses are an important motivation to the CEO and staff.

CHDO Board Representation

ACLC continuously works to keep proper representation of its board members from low-income communities or representative of low-income organizations based on the CHDO guidelines.

1999

Mr. Buster Rappe
Low Income Tenant from Cedar Gardens Apartments

42 N. SUTTER STREET, SUITE 406 • STOCKTON, CALIFORNIA 95202 • PHONE (209) 466-6811 • FAX (209) 466-3465

A Multi-Cultural Housing Development Corporation

A Section 8 recipient and Chairman of the Tenant Council of Cedar Gardens

Mr. Daniel Ramos – Retired Farmworker
Board Member Since 1987

President of the Farmworker Families

In the year 2001 Mr. Ramos suffered a second heart attach but did not desire to leave the board. Mr. Ramos continues to sit on the board.

Mr. Ruben Garza

Principal of Monroe Elementary School

This school is located in the poorest community of Stockton.

Mr. Garza was elected to represent Migrant Education and migrant families

Mr. Garza continues to sit on the board.

Mr. Garza represents many different grassroot organizations that deal with migrant farm labor families. We have enclosed a letter from the University of the Pacific that states that Mr. Garza is a member of the Advisory Board. Additionally, we enclosed a letterhead that shows that Mr. Garza position with the BEAM Scholarship Association.

2001

Mr. Frank Henderson replaced Buster Rappe. Mr. Rappe suffered a heart attack and could not continue his duty on the Board. Mr. Rappe was well known by HUD Officials in San Francisco for his outstanding work with the resident Council of Cedar Gardens.

Mr. Henderson is a resident at Delta Plaza (an ACLC senior project) and represents the seniors of our community. Mr. Henderson is a very low-income individual.

2002

The same board members still sit on the board. ACLC would like this issue to be removed from the report.

Cost Allocation Plan

ACLC has hired its' CPA to implement a cost allocation plan that will be in effect by January 2003.

Actual or Apparent Conflicts of Interest

ACLC's office lease agreement with a corporation partially owned by an ACLC Board Member is an issue that ACLC tried to clarify with HUD some time ago. Because The Board Member's interest is so small (10%) ACLC requested HUD to

assist this matter and perhaps obtain a waiver or other resolve. ACLC staff attempted to cure this issue and had requested the help of a Community Builder, in the Sacramento Office. Prior to receiving help with a resolution to this problem. ACLC received notice of denial for participation in the re-certification of its' Non-Profit Agency in the Single Family Programs due to personal bankruptcies as well as a Board Member's interest in the office space.

Church Street Property, ACLC met a property owner while making a presentation in the Gleason Park neighborhood. After the presentation the property owner informed us that she wanted to sell her property located in the Gleason Park neighborhood. Since ACLC was currently acquiring properties in this neighborhood to assemble a large project ACLC made her an offer. ACLC was unaware of any potential conflict of interest. In the future we will seek to improve this deficiency by further investigation into the Seller's of property.

In conclusion, ACLC believes that this report should also include the strengths of our organization and its' accomplishments. Since 1993 ACLC has re-habilitated or constructed over six hundred and five units housing to very low and low-income families or individuals through out the Central Valley. The units are beautifully maintained and the vacancy rate is below 1 percent. In relationship to HOME dollars in a project ACLC has leveraged funds at a ratio of one to three, for every one HOME dollar ACLC brought in three. Not only has ACLC brought additional dollars into the Cities, we have taken the toughest neighborhoods, in our Cities and begun to turn what was once crime infested neighborhoods, into beautiful housing for the poor, a place where their children can play. All of what was intended to be accomplished with the HOME program. We must not forget, that ACLC since 1993 constructed or renovated over 213 single-family homes that have provided homeownership and the American Dream for low income families in the Central Valley.

ACLC would like to request that this information be added into this report. The Board of Directors and ACLC staff has worked tirelessly to develop housing when no one else has stepped to the plate to address housing for low-income people. This is the spirit of the HOME program and what is missing from your report.

Sincerely,

ACLC, Inc.



Carol J. Ornelas
Chief Executive Officer

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