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

July 24, 2003

MEMORANDUM No.:
2003-NY-1802

MEMORANDUM FOR: Michael Litvin, Acting Director, Office of Community Planning and Development, 2ADMA

Edgar Moore
for

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

SUBJECT: Safe Space, Inc.
Housing Opportunities for Persons with Aids,
Grant No. NYH00-0020, and
Supportive Housing Program, Grant No. NY36B97-0025
New York, New York

INTRODUCTION

We completed a review of the books and records of Safe Space, Inc. (herein referred to as the Grantee) pertaining to its Housing Opportunities for Persons with Aids (HOPWA) Program, and Supportive Housing Program (SHP). We performed the review pursuant to a request made by the Director, Office of Community Planning and Development in Region 2 of the U.S. Department of Housing and Urban Development (HUD). The objectives of the review were to determine whether the Grantee (1) maintained adequate books and records to account for expenditures charged to the programs, and (2) expended grant funds only for eligible program activities in an economical and efficient manner and in accordance with the grant agreements and applicable laws and regulations.

METHODOLOGY AND SCOPE

To accomplish our objectives, we interviewed members of the Grantee's staff who are responsible for the administration of program activities. We also reviewed the Grantee's accounting records, and other supporting documents pertaining to the expenditures of HOPWA and SHP funds. This included a review of the Grantee's program policies and procedures manual; board meeting minutes, personnel records, employee time distribution records, purchase orders, invoices/billings, and receipts. Additionally, we reviewed the requirements of the HOPWA and SHP Grant Agreements, Title 24 of the Code of Federal Regulations (24 CFR), Part 84 Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals and Other Non-Profit Organizations; 24 CFR Part 574, Housing Opportunities For

Persons With Aids; 24 CFR Part 583, Supportive Housing Program; Office of Management and Budget (OMB) Circular No. A-122, Cost Principles for Non-Profit Organizations; and OMB Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations. We attempted to test $785,394 in expenses charged to the HUD Grants ($273,591 out of a total of $537,201 expended from the HOPWA Grant, and $511,803 out of a total of $1,675,799 expended from the SHP Grant) during the period we reviewed.

The review covered the period between January 1, 1999, and September 30, 2001. We conducted the audit fieldwork during the months of October 2002 through March 2003. This memorandum contains one finding with recommendations for corrective actions.

BACKGROUND

Safe Space, Inc., formerly known as "The Center For Children & Families", was established in 1919 by a privately funded group of concerned citizens to protect and nurture abused, neglected, and abandoned children in New York City. The non-profit's mission is to provide a safe environment where youth, and families can grow, thrive, and embark on the path towards self-sufficiency. In order to achieve this mission, Safe Space offers programs in community health, school collaborations, mental health, and youth and family services. The programs provide services to over 30,000 children and families each year.

To facilitate one of its many goals, Safe Space, Inc. applied for and received two HUD program grants, as follows:

Program Name	Grant No.	Contract Amount	Period	Amount Expended
HOPWA	NYH00-0020	$1,278,906	04/03/01 to 04/02/04	$ 537,201
SHP	NY36B97-0025	$1,675,800	01/06/99 to 01/31/02	$1,675,799

HUD established the HOPWA Program in 1992 to address the special needs of individuals living with HIV/AIDS and the family members who reside with them. The program offers grants to local communities, states, and non-profit organizations to provide housing assistance, and related supportive services.

The Supportive Housing Program was commissioned by Title IV, Subtitle C, of the McKinney-Vento Homeless Assistance Act of 1987, as amended. The program provides grants to States, local governments, other governmental entities such as Public Housing Agencies (PHA), and nonprofits to develop supportive housing and services that will enable homeless individuals to live as independently as possible. In addition, the program is designed to assist homeless individuals in meeting three overall goals, which are to: (1) achieve residential stability; (2) increase their skill level and/or incomes; and (3) obtain greater self-determination.

The HOPWA and SHP grants funded activities administered by Safe Space's Homeless Youth Services (HYS) Division. Specifically, the HOPWA Grant renewed funding for a project earmarked for HIV and multiple diagnosed homeless youth entitled, the "NYC Youth MDI Housing Project II" based out of the Times Square Drop-In-Center. The Drop-In-Center, which officially opened in 1992, was the entry point for 13 to 24 year old youths seeking basic services, such as, a safe place to sleep, showers, laundry facilities, hot meals, and clothing. Additionally, the Drop-In-Center provided comprehensive case management, crisis intervention, assessment, assistance in obtaining identification, housing placement assistance, mental health and medical services, HIV testing and counseling, job training and placement, as well as life skills.

The SHP Grant was used to expand the hours of the Times Square Drop-In-Center from 8 to 24 hours a day, 7 days a week.

Within the first four months of the HOPWA Grant (April 3, 2001 to August 2, 2001), the Grantee drew down $537,201 or 42 percent of the total Grant amount. Furthermore, all except $1 of the SHP Grant was drawn down by July 19, 2001, six and one/half months prior to the Grant Agreement's expiration date of January 31, 2002.

On May 6, 2002, Safe Space terminated the HOPWA Grant, and discontinued all operations at the Drop-In-Center. The primary reason given for the Drop-In-Center's closure was the loss of donated space where the center had operated since 1992.

RESULTS OF REVIEW

Our review disclosed that during the period reviewed, the Grantee neither maintained adequate books and records to account for expenditures charged to the programs, nor adequate documentation to support that grant funds were only expended for eligible program activities in an economical and efficient manner, and in accordance with grant agreements, applicable laws and regulations. Specifically, the Grantee failed to properly maintain accounting records to document the basis for allocating costs charged to the individual grant programs. This occurred because officials of the Grantee did not comply with Federal requirements and regulations pertaining to charging of costs to grant programs, which provide that actual conditions must be taken into account when selecting a base to be used in allocating costs to each grouping of benefiting functions. Consequently, the Grantee could not provide adequate assurances that $2,213,000 ($537,201 for the HOPWA and $1,675,799 for the SHP funds) in costs either paid with grant funds or allocated to activities were actually applicable to the grant programs; as such, we designated these costs as being unsupported (See Appendix A).

Details pertaining to the deficiencies are described in the one finding contained in this memorandum. We discussed the contents of the finding with Grantee officials during our review and at an exit conference held on June 30, 2003. The Grantee provided us with their written response to the finding, which we included in its entirety as Appendix B to this memorandum. We also provided a summary and an evaluation of the Grantee's responses at the end of the finding.

FINDING

The Basis For Allocating Costs Charged To The HUD Funded Grant Programs Was Not Supported

Contrary to Federal requirements, the Grantee failed to properly maintain accounting records to document the basis for allocating costs charged to its HUD funded Housing Opportunities for Persons with Aids (HOPWA) Program, and Supportive Housing Program (SHP). This occurred because officials of the Grantee did not comply with Federal requirements and regulations pertaining to charging of costs to grant programs, which provide that actual conditions must be taken into account when selecting a base to be used in allocating expenses to each grouping of benefiting functions. Consequently, the Grantee cannot provide proper assurance that $2,213,000 ($537,201 for the HOPWA and $1,675,799 for the SHP) in costs that were paid with grant funds or allocated to activities were actually applicable to the grant programs. Accordingly, we consider these costs unsupported, and recommend that the Director, Office of Community Planning and Development (CPD) of HUD's New York Field Office, instruct the Grantee to submit to HUD, adequate proof that the percentages used to allocate costs to the HUD grants produced allocated amounts that were commensurate with the benefits derived. Also, we recommend that the Grantee develop procedures to ensure compliance with all Federal requirements and regulations pertaining to charging costs to grant programs.

Criteria

OMB Circular A-122, Attachment A, Paragraph A, subparagraph 2(g) provides that "to be allowable under an award costs must be adequately documented." In addition, Paragraph D, subparagraph (3)(c), entitled "Allocation Bases" provides that "actual conditions shall be taken into account in selecting the base to be used in allocating the expenses in each grouping of benefiting functions. The essential consideration in selecting a method or base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived…" Attachment B, Paragraph 7, subparagraph m (1) states, "Charges to awards for salaries and wages whether treated as direct or indirect cost will be based on documented payrolls…The distribution of salaries and wages to awards must be supported by personnel activity reports…" Furthermore, subparagraph m (2)(a) provides, that "The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards."

Furthermore, OMB Circular A-133, Section 300(b**)** states that the Grantee shall "maintain internal control over Federal programs and provide reasonable assurance that the Grantee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs."

Drop-in Center established with multiple funding sources

In 1992, Safe Space, Inc. opened a Drop-In-Center to provide supportive and referral services for homeless youths. During the period between July 1, 1998 to June 30, 2002, we noted that the Grantee received over $11 million in Federal, State, City and Private funding to facilitate the Drop-In-Center's operations. The funding was commingled into one general operating account and all Drop-In-Center related expenses were paid from that account. We noted that the Grantee did not always properly account for and allocate expenditures incurred to specific grants. We also noted that if the Grantee could not determine where to charge an expense, then it was charged to cost center 120, currently cost center 360, entitled "Safe Space" (a general cost center). Cost center 360 became a cost account where all costs that were not allocated or charged directly to specific grants were charged.

All costs not allocated to a specific grant were charged to a general cost center

According to an internal Safe Space memorandum we obtained entitled, "HUD Programs As of June 30, 2000," the HUD SHP and HOPWA Grants did not have enough expenses to support past and future claims for reimbursement from HUD. Therefore, the Grantee decided to allocate the expenses from cost center 120 (a general cost center) to the SHP and HOPWA program using a 60/40 percent split. This was done by means of several large adjusting journal entries, which were made at the Grantee's June 30th year-end. It should be noted that the above internal memorandum and the method of allocating costs using the 60/40 percent split was applicable to the SHP Grant under our review and to a prior HOPWA grant that we did not review. The HOPWA Grant (NY36H97-0093) referred to in the internal memorandum predated the renewal grant (NYH00-0020) that we focused on during our review.

General cost center charges were arbitrarily allocated to the HUD grants using a 60/40 percent split

Nevertheless, the Grantee asserted that for the most part, expenses were charged directly to the renewal HOPWA Grant that we reviewed. However, we noted that the majority of invoices provided in support of the HOPWA expenses were stamped cost center 360, indicating that the expenses were initially charged to the general cost center, and not to the HOPWA Program, cost center 303. A Grantee official said that the costs were charged to the general cost center in error; as such, the official provided complicated adjusting and

Adjusting journal entries were used to allocate general cost center charges to the HUD grant

reversing journal entries to demonstrate that the expenses were later reclassified.

The Grantee did not provide assurance that reclassified costs belonged to the HUD grant programs

Because the Grantee did not provide a reasonable explanation for allocating 60% of the expenses originally charged to cost center 120 to the HUD SHP Program, we believe that this method was arbitrary and may have unfairly allocated costs incurred by other programs to the HUD Grant. Furthermore, the Grantee did not provide adequate evidence that a substantial amount of costs was charged to the general cost center in error that actually belonged to the renewal HOPWA Program; thus, we were unable to determine whether those costs, which were subsequently reclassified and charged to the HUD HOPWA grant, were for activities actually carried under the program. We believe this occurred because the Grantee failed to maintain adequate accounting records to identify the expenses incurred under the HUD Grants.

Grantee time records do not show employee specific activities to support charges to the grants.

We selected for detailed testing $546,320 or 33 percent of the $1,675,799 in expenditures related to the SHP and $273,591 or 51 percent of the $537,201 in expenditures related to the HOPWA Program. These expenses were itemized on the Grantee's June 2000, and June 2001 Statement of Revenue and Expenditures for these programs respectively. Included in these amounts are $351,680 and $116,289 in salaries/payroll expenses related to the SHP and the HOPWA program respectively. Our review of the payroll costs charged to both the SHP and the HOPWA Program disclosed that the Grantee did not furnish a logical or reasonable basis for the percentages used to allocate salary costs to the HUD grants. The Grantee provided a spreadsheet entitled "Drop-In Matrix With Increase Dates," which contained the percentages used to allocate employee salary charges to the various cost centers or grant programs. However, the time distribution records did not adequately support this spreadsheet. Although several of the time records examined contained a checkmark that stated, "I am assigned to more than 1 GRANT (aka: PROGRAM) and have completed the reverse side," we noted that the reverse sides of the time records were not completed. The time distribution records merely reflected "Starting Time," "Time Out," "Ending Time," "Net Time Worked," and contained the employee and supervisor signatures. Furthermore, the time records did not indicate whether the employee worked in the "A.M." or "P.M." hours at the 24 hour Drop-In-Center. This is contrary to the requirements of OMB Circular A-122, which require charges to grants for salaries and wages to be based on an after-the-fact determination of the actual activity of each employee. The

Salary charges to the HUD grants are questioned and considered unsupported

allocation percentages used to distribute employee salaries, which was determined before the work was performed, namely the spreadsheet entitled "Drop-In Matrix with Increase Dates", does not qualify as support for charges to the grants. As a consequence, the Grantee does not have adequate documentation to support the salaries allocated to the HUD grants; therefore, we question the allowability of those costs and consider the salary charges to the SHP and the HOPWA programs as unsupported.

$2,213,000 in HUD grants received is considered unsupported

To test the other expenditures charged to both the SHP and the HOPWA program, we requested all invoices, contracts, canceled checks, and other documentation that would support the expenses shown on the Grantee's June Statement of Revenues and Expenditures. Although the Grantee was able to provide several supporting documents, we noted that the majority of the invoices supported expenses charged to the general cost center 360 (formerly 120), and not to the SHP cost center 306 or the HOPWA Program cost center 303. We found that there were only a few direct charges to the HUD grant programs and that the support provided, for these and other charges, did not contain sufficient evidence showing that the charges were actually incurred for the SHP or the HOPWA Program. We found that the Grantee used complicated year-end adjusting and reversing entries to allocate expenses to the HUD grant programs without an adequate basis. Consequently, the Grantee failed to maintain adequate support for costs charged to the HUD programs, as required by OMB Circular A-122. This occurred because the Grantee neither maintained adequate accounting records nor adequate documentation to support the allocation of expenses charged to the HUD HOPWA and SHP Grants. Accordingly, the Grantee was unable to provide adequate assurance that $2,213,000 ($537,201 for the HOPWA and $1,675,799 for the SHP) in HUD grants were used to pay costs incurred specifically by these grant programs; therefore, we consider these costs as unsupported.

The Grantee drew down funds in excess of program needs

Apart from the above, we noted that the Grantee drew down funds in excess of program needs. For example during the period from March 1999 through January 2000, the Grantee drew down $672,000 from HUD for the SHP. However, when we examined its books and records for the same time period, the general ledger only reflected $198,534 in expenses charged to the SHP Program. As such, we believe that the difference of $473,466 represented funds drawn down in excess of incurred program costs. Specifically, we noted similar differences in eight of the Grantee's thirteen SHP vouchers that were used to request funds from HUD. In this regard, the Grantee violated the financial instructions accompanying the SHP

Grant Agreement, which provides that "Funds drawn down should be disbursed in payment of program costs within three days of receipt of funds. That is, grantees should not drawn down funds unless they expect to expend those funds within three days." Additionally, we noted that the Grantee drew down 42 percent of its $1,278,906 HOPWA grant in the first four months of the award. Consequently, the Grantee failed to ensure that the funds awarded would be available throughout the term of the HOPWA grant agreement. This contributed to HOPWA funds being suspended by HUD. In this regard, we believe that the Grantee should not be allowed to draw down funds unless adequate proof is provided showing that expenses have been incurred in the amount of the funds requested, and that those funds will be disbursed to vendors within three business days, as required.

Grantee comments

The Grantee maintains that it keeps adequate books and records as required by Federal, State and City law and it provides that nowhere does the Inspector General (IG) point to any law that requires the Grantee to maintain records beyond what was provided to the IG. The Grantee further states that inadequate books and records have never been cited in any financial audits performed on it.

The Grantee does recognize that because of the complexity of the Housing Youth Service (HYS) Division and the number of contracts associated with the Drop-in-Center, some expenses may have been erroneously allocated to certain cost centers (360). However, it contends that the errors were corrected by the Grantee's Fiscal Department via adjusting journal entries. Furthermore, the Grantee states that the IG misinterpreted a cost center for homeless programs (cost center 120, currently 360) for a general cost center. This cost center was used for only items earmarked for the HYS-applicable revenue and expenses. Also, since it is common for social service organizations to flow all cash activity through a common operating bank account, the implementation of a single bank account for HUD contracts was not practical but would have been time consuming and labor intensive since the agency was experiencing numerous vacancies. In addition, a HUD bank account would not be appropriate on the disbursement side since there was sharing of expenses between grants.

The Grantee states that the HYS Drop-in-Center is itself funded by 13 separate government contracts each of which requires a financial match to subsidize a portion of the program. However, the Grantee believes that the IG misinterpreted the Grantee's internal memorandum in that cost incurred (over $885,000) by the HYS Division was allocated directly into cost center 360, then reallocated to the HUD funded programs per the discretion of the Division Director. The allocation is not done in an arbitrary manner, but in accordance with contractual requirements. Furthermore, the Grantee states that the IG has incorrectly interpreted OMB Circular A-122 to mean that salary costs cannot be allocated in the manner in which the Grantee did. The Grantee states that its salary allocation is based on the premise that at hiring, personnel are assigned an allocation as approved by the Division Director. Accordingly, Directors approve employee time cards and payroll records with full knowledge that a pre-existing allocation of the employee's salary has been made. The Grantee also states that by relying on OMB Circular A-122, Attachment B, paragraph 7, subparagraph (m) the IG has invoked an indirect cost allocation methodology and applied it to a direct cost allocation method used by the Grantee.

The Grantee states that the HYS Division maintained a deficit throughout its operations, because the demand for services was greater than anticipated. Nevertheless, although the Grantee drew down funds in excess of incurred program costs, the fact that the program ran at a deficit leads to the conclusion that HUD funds were fully expended in connection with those programs. In conclusion, the Grantee states that the IG adopted an interpretation of what constitutes "adequate books and records to account for expenditures", however; it found no support for this interpretation in the governing rules and regulations.

OIG evaluation of Grantee comments

The Grantee stated that inadequate books and records have never been cited in any financial audits performed on its books and records. In the professional field of accounting and auditing it is understood that because a condition is not cited does not necessarily mean that the condition does not exists. While the Grantee's statement is not a valid comment, we believe that the following responses to the Grantee's comments will validate our position that the Grantee's books and records were not adequately maintained.

The Grantee provides that expenses erroneously allocated to certain cost centers, including the "Safe Space" cost center 360, were corrected via adjusting journal entries. During the course of our review, we attempted to evaluate the validity of those adjusting journal entries and to determine whether they were made to the proper grants by tracing them to their "origins." However, we were neither able to determine, nor was the Grantee able to provide us with the origin of those entries. Furthermore, the Grantee could not adequately show that the adjustments were made to the proper grant accounts. The complexity of determining the validity of the adjustments was enormous because the grantee chose one month as a "reconciling month" for which the General Ledger balances for the line item grant accounts were zero, and for which grant expenses were charged to the accounts through the aforementioned adjusting journal entries. Furthermore, the Grantee contends that cost center 360 was not a general cost center by stating that it was used for only HYS expenses. Nevertheless, despite the fact that the HYS was funded by Federal, State, City, and private funding sources, the Grantee chose to allocate the majority of all costs to the HUD grants, as opposed to allocating them to all HYS funding sources based on a supported allocation method. Thus, it is our opinion that the Grantee's allocation method was unsupported and its books and records were not adequately maintained.

Since the Grantee admits that the HYS Drop-in-Center was funded by 13 separate government contracts, we believe that prudent accounting practices would have dictated that costs be allocated among the thirteen government contracts based on a supported allocation method designed to distribute costs to each entity in accordance with benefits derived. This is also required pursuant to OMB Circular A-122 Attachment A, paragraph D, subparagraph 3(c). The Grantee contends that we misinterpreted its internal memo pertaining to how expenses were allocated from cost center 120 to the HUD funded grants. However, it is our position that we have not misinterpreted the information in the internal memo since it states that expenses of cost center 120 will be reallocated to the HUD grants using a 60/40 percent ratio. Regarding this matter, the Grantee could not explain the Division Directors rationale for using these percentages; as such, we believe that this method of allocation was arbitrary. Also, the allocation was not based on activity specific time records, as explained in the finding. Furthermore, employee personnel records did not contain any evidence as to which cost center an employee was assigned when hired. As for misinterpreting OMB Circular A-122 and applying an indirect cost methodology to direct cost, we have clarified the criteria (OMB Circular A-122 Attachment B Paragraph 7 m (1) and m (2)) in the finding, which states that "…charges to awards for salaries and wages, whether direct cost or indirect cost, will be based on documented payrolls…supported by personnel activity reports," which should

"…reflect the after-the-fact determination of the actual activity of each employee."

The Grantee's comment that "Safe Space ran a deficit in those eligible programs leads to a conclusion that HUD funds were fully expended in connection with those programs", does not address our concern that funds were drawn down in excess of incurred program costs. In fact, the results of our review showed that those deficits occurred after the Grantee made numerous adjustments at year-end. Accordingly, as stated in the finding, the Grantee drew down funds in excess of program needs in violation of the SHP Grant Agreements.

Recommendations

We recommend that HUD, the Director, Office of Community Planning and Development (CPD), New York Field Office:

A. Instruct the Grantee to obtain an Independent Public Accounting (IPA) firm to evaluate the manner in which costs were allocated to the various HUD grant programs and other funding sources. The IPA should certify whether the method used to allocate costs produced allocated amounts that were commensurate with the benefits derived.

B. Instruct the Grantee to reimburse to HUD any amount of the $2,213,000 ($537,201 for the HOPWA and $1,675,799 for the SHP Programs) that the IPA does not certify to as being eligible costs that is allocable to the HUD funded grant programs.

C. Require the Grantee, for any future awards, to engage the services of an IPA to develop a Cost Allocation Plan, which should be submitted to HUD for approval prior to awarding or disbursing any additional funds to the Grantee.

D. Instruct the Grantee to maintain adequate time distributions records that are activity specific, to support salaries and wages charged to the HUD Grant Programs in accordance with the requirements of OMB Circular A-122.

E. Direct the Grantee to develop procedures to ensure that grant funds drawn down are expended in payment of program costs within three days.

F. Conduct a monitoring review, within a reasonable time period, of the HUD Grants administered by the Grantee to determine whether corrective measures have been implemented.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, 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. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

We appreciate the courtesies and assistance extended by the personnel of Safe Space, Inc. during our review. Should you or your staff have any questions, please contact Edgar Moore, Assistant Regional Inspector General for Audit or me at (212) 264-8000 extension 3976.

SCHEDULE OF QUESTIONED COSTS

Type of Questioned Costs

Finding	Unsupported **1/**
1	$2,213,000

1/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures

Safe Space NYC, Inc.

Response to the U.S. Department of Housing and Urban Development
Draft Audit Memorandum

June 30, 2003

GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to the U.S. Department of Housing and Urban Development
Draft Audit Memorandum

June 30, 2003

1

GRANTEE COMMENTS

BDO

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June 30, 2003

Mr. Alexander C. Malloy
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278

Dear Mr. Malloy:

The Board of Directors of Safe Space NYC, Inc. ("Safe Space") has requested that our firm assist the management of Safe Space in responding to the draft Audit Memorandum report that management received from your office. It should be noted that our firm has been the independent auditors for Safe Space since the fiscal year-ended June 30, 1998.

Background

Our understanding is that the HUD-Office of Community Planning and Development ("HUD CPD") directed the Inspector General to undertake the following review:

- Determine whether Safe Space maintained adequate books and records to account for expenditures charged to the programs.
- Determine whether Safe Space expended grant funds only for eligible program activities in an economical and efficient manner and in accordance with grant agreements and applicable laws.

The Inspector General's Finding

Following the Inspector General's review, a draft audit memorandum report was prepared on or about June 6, 2003 and submitted to Safe Space for comments. The Inspector General concluded that Safe Space could not substantiate 100% of the expenses reported for the period of January 1, 1999 through September 30, 2001. The Inspector General further recommended that the HUD CPD instruct Safe Space to obtain an evaluation by an independent public accounting firm of the manner in which costs were allocated to various HUD grant programs and other funding sources. The Inspector General also recommended that, if the independent public accounting firm is unable to certify the method used to allocate costs, that Safe Space be required to reimburse HUD in the amount of $2,213,000.

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GRANTEE COMMENTS

BDO

Summary of Safe Space's Response:

As we show in the body of this response, the Inspector General has adopted an interpretation of what constitutes "adequate books and records to account for expenditures" that, to our knowledge, finds no support in the governing rules and regulations. Moreover, the Inspector General's interpretation would impose an undue burden on a not-for-profit entity like Safe Space, which receives funding from multiple sources for the services it provides. In contrast to the Inspector General, our firm, which has been the independent auditors for Safe Space since the fiscal year ending June 30, 1998, has issued certified financial statements which support that Safe Space expended grant funds only for eligible program activities in accordance with grant agreements and applicable laws. The Inspector General appears to recognize the unsettled basis for his conclusions when he concedes that his conclusions "might involve a legal interpretation or clarification of Departmental policies and procedures." To the extent the Inspector General's report relies on unclear policies or unsettled issues of law, Safe Space should not be held accountable for failing to comply with those unclear standards.

Accordingly, the Inspector General should correct his draft Audit Memorandum to reflect the information provided in this response. Alternatively, if the Inspector General declines to correct his report, the HUD CPD should reject the Inspector General's recommendations.

Sincerely,

BDO Seidman, LLP

BDO Seidman, LLP

GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum Of HUD Office of Inspector General June 30, 2003

I. *Nature of the Organization*

Background

Safe Space is a multi-service agency dedicated to working with youngsters who have been devastated by their life experience and providing them with a second chance. Since 1919, Safe Space has collaborated with families, schools, and communities to protect helpless children from abuse and neglect. The agency advocates for children and intervenes early in life, with programs designed to nurture them and bring out their potential.

During the last full fiscal year under your review (year-ended June 30, 2001), Safe Space maintained an operating level just over $24,000,000 supported by nearly 900 employees, while administering over 60 different program contracts. The agency was separated into 7 different programmatic divisions: Mental Health Services, Community Health Services, Residential Services, Homeless Youth Services ("HYS"), Preventive Services, Employment and Training Services, and Education Services. Supporting Services, or Management and General and Fundraising, make up approximately 10% of Safe Space's operations.

In 1991, HYS began its operations by signing a lease for space for a midtown New York Drop-In-Center. Fundraising during the first year allowed Safe Space to renovate the facility and open a small program in 1992. From that very modest beginning with approximately ten staff members and volunteers, and a budget of approximately $400,000, the Safe Space HYS Division quickly grew to almost a $5,000,000 budget, with a staff of nearly 60 making a four-borough, 24-hour, 7-day a week outreach effort with the fullest array of services of any HYS provider in New York City. This rapid growth of varied and unique services resulted in a significant increase in demand for services that far exceeded Safe Space's financial resources.

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GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

In its last full fiscal year of operations (year-ended June 30, 2001), Safe Space's HYS Division was funded by roughly 20 government contracts. For the same period, the HYS Division showed an operating deficit of approximately $(442,860), or, a 9% loss on operations.

During the fiscal year ending June 30, 2002, HUD CPD wrote to Safe Space concerning the "apparent premature drawdown of federal funds." Safe Space responded to this inquiry on December 21, 2001, explaining the rationale for this drawdown. Following Safe Space's response, HUD made no further inquiries on this subject and never contacted Safe Space to indicate that its response had in any respect been insufficient or unacceptable.

HUD itself has recognized the importance of the services that Safe Space provides. In a letter dated December 11, 2001, Joseph A. D'Agosta, the CPD Director, New York State Office wrote to Safe Space that, "We are aware that Safe Space, NYC, Inc. has a reputation for operating programs that provide great benefits to homeless and HIV positive youth."

GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

II. ***The Inspector General's Comments and Safe Space's Responses to those Comments***

The Inspector General's draft memorandum contains a single finding, namely, that "The Basis For Allocating Costs Charged to The HUD Funded Grant Programs Was Not Supported." That single finding then purports to be supported by a series of comments. We respond to the Inspector General's comments below.

Inspector General's Comment:

The Inspector General concluded that Safe Space did not maintain adequate books and records to account for expenditures charged to the programs.

Response

Safe Space has, and continues to maintain adequate books and records as required by applicable federal, New York State and New York City law. During the course of the Inspector General's six-month financial review, Safe Space provided a wide range of documentation including, but not limited to, approved invoices, time-keeping records, payroll documents and reports, personnel files, and any general ledger documentation as requested.

It is important to note that the Inspector General nowhere points to any federal or state law that requires Safe Space to maintain records beyond those that were provided to him. Indeed, missing documentation was not a finding of this financial review. In his draft memorandum, the Inspector General notes that his conclusions "might involve a legal interpretation or clarification of Departmental policies and procedures." While this may well be the case, Safe Space believes that it cannot and should not be held accountable for any lack of clarity concerning the records that HUD, as a matter of policy and procedure, prefers grantees to maintain.

It is important for HUD to recognize that Safe Space has withstood all financial audits from both government agencies and Independent Public Accountants to date. Inadequate books and records have never been cited as a finding during any of those reviews.

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GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

Inspector General's Comment:

The Inspector General concluded that Safe Space did not maintain adequate documentation to support that grant funds were only expended for eligible program activities in an economical and efficient manner, and in accordance with grant agreements, applicable laws and regulations.

Response

As noted earlier, Safe Space's HYS Division was funded by nearly 20 different government contracts segregated by 20 different cost centers. The Drop-In-Center, the hub of the HYS operation, located in mid-town Manhattan, was alone supported by 13 different contracts. The HOPWA and SHP grants were two of these contracts. All expenditures rooting from the Drop-In-Center were HYS applicable and were allocated as such. Furthermore, these expenditures were 100% applicable to HYS, as sharing of direct costs among Safe Space's Program Divisions was prohibited.

During the course of the 6-month review, all documentation was provided as requested. Documentation to support eligible program activities was provided in the form of invoices and payroll records. All applicable expenses allocated to HYS were solely for program activities initiated in the HYS Division. All expenditures bore the signature of the HYS Division Director.

We are unaware of any specific guidance either in the grant itself, issued by OMB, or from any other source indicating that specific records must be kept beyond the general requirement that Safe Space maintain adequate documentation to justify that the expenses charged to the grant were in fact applicable to the grant. There is nothing in federal law that prohibits Safe Space from adhering to the policies that it had in place. Accordingly, Safe Space's recordkeeping was fully consistent with applicable law. To the extent the Inspector General believes that additional obligations existed, he has not referenced any authority for that proposition in his draft report and Safe Space cannot and should not be held responsible for an interpretation of HUD policy of which it was never made aware.

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GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

Inspector General's Comment:

The Inspector General concluded that Safe Space failed to properly maintain accounting records to document the basis for allocating costs charged to the individual grant programs.

Response

In our opinion, Safe Space properly documented all general journal entries as well as the basis for all adjustments. Therefore, the allocations in question, which were based on adjustments to the general ledger to reallocate expenses charged to a single cost center, were appropriate. The Inspector General suggests that the methodology employed by Safe Space was somehow insufficient. However, the Inspector General nowhere points to any requirement of the grant or applicable law to support his position. As Safe Space's independent auditor, we believe that it fully documented and supported the basis for its journal entries and adjustments. To our knowledge, nothing more was required of Safe Space.

Safe Space policy dictates that all expenditures are to be approved and allocated to relevant cost centers by the Division Director. We recognize that, as a result of the complexity of the HYS Division and the number of contracts associated with the Drop-In-Center operations, some expenses may erroneously have been allocated to certain cost centers initially. However, in order to correct this problem, Safe Space's Fiscal Department met with the former HYS Director and HYS staff to achieve proper allocation of all HYS contracts via various adjusting journal entries. The Inspector General himself recognized that the original allocation errors were limited in scope when he wrote, "the Grantee did not always properly account for and allocate expenditures incurred to specific grants." As we have noted above, to the extent some errors occurred, they were corrected by Safe Space's Fiscal Department.

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GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

Inspector General's Comment:

The Inspector General concluded that when Safe Space could not determine where to charge an expense, it was charged to cost center 120 (currently cost center 360), entitled "Safe Space" (a general cost center). Cost center 360 became a cost account where all costs that were not allocated to specific grants were charged.

Response

The Inspector General's Comment reflects a misunderstanding of Safe Space's accounting system. The Inspector General appears to have misinterpreted a cost center for homeless programs to be a *general agency cost center merely because the name of the cost* center was "Safe Space."

Before being known as "Safe Space," the agency was named "The Center for Children + Families." The HYS Division, prior to the name change, was labeled "Safe Space" due to the nature of its operations. Thus, a cost center was established titled "Safe Space" that was to be used to account for private donations temporarily restricted to the HYS operation. Expenses that were to be matched against this private income were to be allocated to cost center 360 (previously cost center 120).

Safe Space used this cost center only for items that were earmarked for HYS-applicable revenues and expenses. Therefore, cost centers *120 and 360 were not general cost centers for the agency as the* Inspector General incorrectly concluded, but were division-specific. Of course, we have noted earlier that some expenses may erroneously have been allocated to this cost center initially. However, we have also noted that those errors thereafter were corrected via adjusting journal entries.

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GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

Inspector General's Comment:

The Inspector General concluded that Safe Space commingled funding into one general operating account and all Drop-In-Center related expenses were paid from that account.

Response

It is common business practice for multi-funded social service organizations to flow all cash activity through a common operating bank account. Although Safe Space did try to implement separate bank accounts for the HUD contracts as indicated in a letter to HUD dated December 21, 2001, the implementation of a single bank account for the HUD contracts was deemed administratively *inefficient and unworkable for a number of reasons. It would have* been time consuming and labor intensive at a time when the agency's administration was carrying numerous vacancies.

Further, the use of a separate HUD bank account would not have been appropriate on the disbursement side given the sharing of expenses between government grants. In any event, the Inspector General's recommendation regarding separate bank accounts is moot since Safe Space has not received funds from HUD since August 2001.

GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum Of HUD Office of Inspector General June 30, 2003

Inspector General's Comment:

The Inspector General concluded that the HUD SHP and HOPWA Grants did not have enough expenses to support past and future claims for reimbursement from HUD. Therefore, the Grantee decided to allocate the expenses from cost center 120 (a general cost center) to the SHP and HOPWA programs using a 60/40 percent split.

Response

The internal Safe Space memorandum cited in the draft report was misinterpreted by the Inspector General. According to Safe Space records, the HYS Division incurred over $885,000 in expenses that were allocated by the Division Director directly to cost center 360. Safe Space's Fiscal Department met with the former HYS Director and HYS staff to achieve proper allocation of all HYS contracts in order to ensure the survival of the HYS programs. All contracts funding the HYS programs incurred significant deficits in all fiscal years under review. Therefore, the Inspector General's clear suggestion that costs were allocated to absorb reimbursement is incorrect.

Historically, Safe Space has not permitted the sharing of expenses among programmatic divisions. Therefore, all costs incurred and allocated to the HYS Division are applicable to all HYS Grants, as per the definition of program objectives in each of the respective contracts. Further, all costs allocated to HYS are direct costs allocated at the time the expense is incurred per the discretion of the Division Director. This allocation is not done in an arbitrary manner, but in accordance with contractual requirements.

GRANTEE COMMENTS

Safe Space NYC, Inc.

**Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003**

Inspector General's Comment:

The Inspector General concluded that Safe Space did not furnish a logical or reasonable basis for the percentages used to allocate salary costs to the HUD grants. This is contrary to the requirements of OMB Circular A-122, which requires charges to grants for salaries and wages to be based on an after-the-fact determination of the actual activity of each employee.

Response

Safe Space's HYS Drop-In-Center is, by itself, funded by 13 separate government contracts, each of which requires a financial match to subsidize a portion of the program. As a result, by the very terms of the HUD grant, a number of different funding sources are required to contribute to the same program or service activity. The practical effect of this is that the very same services and activities funded by HUD are also funded by other sources. In light of this, the Inspector General has incorrectly interpreted OMB Circular A-122 to mean that salary costs cannot be allocated in the manner that Safe Space did.

Response continued

GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum Of HUD Office of Inspector General June 30, 2003

Response continued

To deal with the reality of its overlapping grants, Safe Space developed a cost allocation methodology to charge each contract with its appropriate share of costs. Safe Space's salary allocation is created on the premise that all cost allocations are applicable to its allocated grants. Further, the Inspector General overlooked the fact that, at the point of hiring, personnel are assigned a salary allocation as approved by the Division Director consistent with the executed government contract budget allowance. Thereafter, on a semi-monthly basis, the Program Director and the Division Director approve employee time cards and payroll records with full knowledge that a pre-existing allocation of the employee's salary has been made. Thus, Safe Space properly tracks the activity after-the-fact for each employee and is in compliance with A-122, which provides, in part, that "*charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports.*"

We also note that, in relying on OMB Circular A-122, Attachment B, paragraph 7, subparagraph (m) the Inspector General has invoked an indirect cost allocation methodology and applied it to a direct cost allocation method of Safe Space. There is no basis of which we are aware for applying indirect cost allocation methods to direct costs. However, if the Inspector General is prepared to invoke such an indirect cost allocation method, he must acknowledge that OMB Circular A-122 specifically allows for the allocation of costs by a method that "produces results that are equitable to both the Federal Government and the organization." The Inspector General nowhere in his report takes this provision of A-122 into account.

GRANTEE COMMENTS

Safe Space NYC, Inc.

Response to Draft Audit Memorandum
Of HUD Office of Inspector General
June 30, 2003

Inspector General's Comment:

The Inspector General concluded that Safe Space drew down funds in excess of incurred program costs.

Response

As noted earlier, the HYS Division maintained a deficit throughout its operations. This is because, as we already discussed, the demand for Safe Space's services was far greater than anyone could have anticipated and Safe Space admittedly struggled to meet that demand. In addition, as we have already acknowledged, some expenses may erroneously have been allocated to the grants initially. We hasten to add, however, that those errors subsequently were corrected via adjusting journal entries. It is important to remember that when Safe Space received funds from HUD, those funds were earmarked specifically for eligible programs. In connection with its audits of Safe Space, BDO Seidman, LLP determined that Safe Space had run deficits in such programs. The fact that Safe Space ran a deficit in those eligible programs leads to the conclusion that the HUD funds were fully expended in connection with those programs.

III. *Conclusion*

The Inspector General adopted an interpretation of what constitutes "adequate books and records to account for expenditures" that finds no support in the governing rules and regulations. Accordingly, the Inspector General should correct his draft Audit Memorandum to reflect the information provided in this response. Alternatively, if the Inspector General declines to correct his report, the HUD CPD should reject the Inspector General's recommendations.