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TO: David M. Kellner, Director, Public Housing Division, Ohio State Office
Donald J. Jakob, Director, Multifamily Housing Division, Ohio State Office

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Capital City Community Urban Redevelopment Corporation
HOPE 1 and HOPE 2 Grant Programs
Westerville, Ohio

We completed a review of the Capital City Community Urban Redevelopment Corporation's HOPE 1 and HOPE 2 Grant Programs. The objectives of the review were to determine whether Capital City: (1) charged costs to the HOPE 1 and HOPE 2 Grants that were reasonable, necessary, and adequately supported, and (2) complied with Grant Agreements and other Federal requirements. HUD's Ohio State Office requested the audit.

The rehabilitation work was in process at the time of our review. The completed rehabilitation work was acceptable. Capital City essentially complied with the Davis Bacon Act and with resident training requirements.

Capital City incorrectly used \$75,713 of the HOPE 2 project's sales proceeds. The funds were used to pay for realty services that Adrian Inc., an identity-of-interest firm, was to provide as part of Capital City's match to the HOPE 2 Grant. Capital City also charged the HOPE Grants \$51,902 of unsupported and ineligible costs. As a result, fewer funds were available to help improve the conditions of the intended beneficiaries, low-income persons.

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

If your staff have any questions, please contact me at (312) 353-7832.

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Executive Summary

We completed a review of Capital City Community Urban Redevelopment Corporation's HOPE 1 and HOPE 2 Grant Programs. HUD's Ohio State Office requested the audit. The general objectives of the review were to determine whether Capital City: (1) charged costs properly to the HOPE 1 and HOPE 2 Grants; and (2) complied with the Grant Agreements and other Federal requirements. The specific objectives were to evaluate the quality of the rehabilitation work, the quality of realty services, the sale of units, compliance with Davis Bacon Act, and the quality of resident training; and to determine whether costs and management fees were reasonable, necessary, and supported.

The rehabilitation work was in process at the time of our review. The completed rehabilitation work was acceptable. Capital City essentially complied with the Davis Bacon Act and with resident training requirements.

However, as the findings show, Capital City did not fully comply with the Grant Agreements and other Federal requirements. Specifically, Capital City did not provide required realty services in selling units and incorrectly used sales proceeds; and charged inadequately supported and ineligible costs and management fees.

Capital City did not provide required realty services and incorrectly used sales proceeds to pay for realtor services

Capital City did not provide realty services and incorrectly used \$75,713 of the HOPE 2 project's sales proceeds to pay for realtor services. The Grant Agreement for Hickory Ridge Townhomes required Adrian Inc., an identity-of-interest company, to provide realty services as part of Capital City's match to the HOPE 2 Program. The Agreement also required Capital City to use sale proceeds for the benefit of low-income people. The commitment by the President of Capital City to provide realtor services influenced HUD's decision to award the Grant to Capital City. Capital City, however, contracted with another realtor to sell the units and paid the contract realtor from sales proceeds. The President of Capital City contracted for the realtor's services because Adrian Inc. had been unsuccessful in selling rehabilitated units at Hickory Ridge. Because Capital City contracted for realtor services, it did not provide the required services without cost to the Grant. Further, because of Capital City's incorrect use of \$75,713 for realty services, these funds were not available for low-income persons.

Unsupported and Ineligible costs of \$42,053 charged to the HOPE 1 and HOPE 2 Grant Programs

Capital City charged inadequately supported and ineligible costs totaling \$42,053 to the HOPE 1 and HOPE 2 Grants. It also overcharged the Grants for an undeterminable amount of salaries and related costs. The Grant Agreements require costs charged to the Grant to be reasonable, supported, and eligible. Capital City had ineffective management oversight that allowed unsupported and ineligible costs to be charged to the Grants programs. Because of these incorrect charges, Capital City had less Grant funds to spend on eligible activities for the benefit of the intended beneficiaries, low-income families.

Capital City charged Hickory Ridge Townhomes \$9,849 of excess management fees

Capital City charged Hickory Ridge Townhomes, the HOPE 2 project, \$9,849 for excess management fees it paid to Adrian Inc. over three years. The Grant Agreement permitted a maximum fee of 5.5 percent of residential income collected and required the owner to obtain HUD approval for any changes. Contrary to this requirement, Capital City and Adrian Inc., identity-of-interest firms, agreed to a 7 percent fee without seeking HUD approval. The President of Capital City and Adrian, Inc. said he had forgotten about the management certification limiting the management fee to 5.5 percent.

Recommendations

We made several detail recommendations in our findings to correct the deficiencies reported. We recommend that Capital City repay the HOPE 2 Program \$75,713 for the incorrectly charged realty services. We also recommend that Capital City repay other ineligible costs and provide support for unsupported costs or repay the Grant programs.

We discussed our findings with Capital City's President throughout the audit. We held a closeout conference on April 4, 1996.

We gave Capital City our draft findings, and it provided us written comments. We considered the replies in preparing our final report. Excerpts with our evaluations are in the findings. Appendix B includes Capital City's comments in their entirety, except for attachments that were not used for the final report.

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Introduction

On November 28, 1990 a set of initiatives called HOPE -Homeownership and Opportunity for People Everywhere was signed into Law. The HOPE Initiatives were to dramatically expand homeownership and affordable housing opportunities to help low-income persons to obtain self sufficiency.

HOPE 1 provided homeownership for low-income persons living in public or Indian housing and single family properties next to other single family public housing properties. HOPE 2 provided homeownership for low-income persons in multifamily properties insured, owned, or held by HUD, Veteran's Administration, Resolution Trust Corporation, Farmer Housing Administration, or State and Local governments.

Capital City Community Urban Redevelopment Corporation was formed in 1988 and became a tax-exempt, non profit organization in June 1991. Capital City's mission was to preserve affordable housing and to promote urban investment/revitalization.

HUD awarded Capital City a \$2,425,483 HOPE 1 Implementation Grant effective March 29, 1993. The Grant was for the conversion of 101 units at Poindexter Towers into condominiums for senior citizens. Capital City had five years to rehabilitate and sell the units.

HUD awarded Capital City a \$3,852,000 HOPE 2 Implementation Grant effective April 30, 1993. The Grant was for conversion of 96 units at Hickory Ridge Townhomes into condominiums for families. Capital City had six years to rehabilitate and sell the units. Both projects were in Columbus, Ohio

The Executive Director and President of Capital City was Charles L. Adrian. Capital City's records and books were at 787 South State Street, Westerville, Ohio.

Audit Objectives

The general objectives of the review were to determine whether Capital City: (1) charged costs to the HOPE 1 and HOPE 2 Grants that were reasonable, necessary, and adequately supported, and (2) complied with the Grant Agreements and other Federal requirements. The specific objectives were to evaluate: the quality of the rehabilitation work, the quality of realty services, the sale of units, compliance with the Davis Bacon Act, and the quality of resident training; and to determine whether costs and management fees were reasonable, necessary, and supported.

Scope and Methodology

We conducted the review at the HUD Ohio State Office and at Capital City. To find out HUD's concerns and obtain

background information, we reviewed HOPE 1 and HOPE 2 program materials, guidelines, Grant applications, Grant Agreements, and other program requirements. We reviewed monitoring records and correspondence. We also interviewed key Ohio State Office staff.

To evaluate Capital City's operations, we reviewed Capital City's general ledgers, cash payment and receipt records, contracts, closing statements, payroll records, indirect cost plan, and 1993 and 1994 certified financial statements. We also interviewed Capital City's staff. To determine whether the rehabilitation work was satisfactory, an Ohio State Office architect and OIG auditors inspected Poindexter Towers and Hickory Ridge Townhomes.

Our audit covered the period from April 1, 1993 through August 31, 1995. We extended the audit period as necessary. We did the field work between September 1995 and April 1996. We conducted the audit following generally accepted government auditing standards. We provided a copy of this report to Capital City's President.

Capital City Did Not Provide Required Realty Services and Correctly Use HOPE 2 Sales Proceeds

Capital City did not provide realty services and incorrectly used \$75,713 of the HOPE 2 project's sales proceeds to pay for realtor services. The Grant Agreement for Hickory Ridge Townhomes required Adrian Inc., an identity-of-interest company, to provide realty services as part of Capital City's match to the HOPE 2 Program. The Agreement also required Capital City to use sale proceeds for the benefit of low-income people. The commitment by the President of Capital City to provide realtor services influenced HUD's decision to award the Grant to Capital City. However, Capital City contracted with another realtor to sell the units and paid the contract realtor from sales proceeds. The President of Capital City contracted for the realtor's services because Adrian Inc. had been unsuccessful in selling rehabilitated units at Hickory Ridge. Because Capital City contracted for realtor services, it did not provide the required services without cost to the Grant. Further, because of Capital City's incorrect use of \$75,713 for realty services, these funds were not available for low-income persons.

HUD Requirements

The HOPE 2 Grant Agreement incorporated the Grant Application and the January 14, 1992 Program Guidelines. The Agreement provided for buying, rehabilitating, and selling multifamily properties held or owned by Government (Grant Agreement, introductory paragraph).

The Agreement required Capital City to complete all work items in the Grant Application within the HUD-approved budget. The work items included all services necessary for the performance of program activities in the Application and Agreement (Article II.(a)).

The Agreement also stated that only the HUD Grant Officer had authority to approve changes from the Agreement and Application. The Grantee was at risk for any unapproved deviations and related costs (Article II.(c)).

The Agreement required Capital City to match part of the Grant funding. Adrian Inc. was to provide basic realtor services and sell the units. Seven percent of the sales price

of each units sold would be counted toward the match (Application Exhibit 22, Paragraph 7).

The basic realty services Adrian Inc. was to provide consisted of the following: prepare Real Estate Purchase Contracts and other necessary forms; provide assistance to the buyers; order credit reports, final title reports, title policies, and inspections; assist potential buyers in finding financing; provide copies of required documents; handle buyers' complaints and concerns; and advertise and sell the properties (Application, Exhibit 22).

The HOPE 2 Agreement required sales proceeds to be used for the benefit of low-income people such as, for business opportunities and support services for the homeownership program (Guidelines, Section 725).

Capital City did not provide required realty services and incorrectly used sales proceeds from Hickory Ridge to pay a realtor

Capital City did not donate realty services as required for its match and did not use the sales proceeds for the benefit of low-income people, as required. Instead, without HUD's permission, Capital City contracted for the realty services and used sales proceeds to pay the contract realtor.

Adrian Inc. was unable to sell Hickory Ridge's rehabilitated units. So on June 17, 1995, Capital City executed three contracts with a realtor to sell the properties. The contracts were with the realtor's three identity-of-interest firms.

The contract realtor was to provide essentially the same basic realty services that Adrian Inc. was to provide. The three contracts together provided that Capital City would pay the realtor a total of \$5,000 for each unit the realtor sold.

As of April 4, 1996, the contract realtor had sold 14 units at Hickory Ridge. The realtor received a total of \$75,713 or \$5,408 a unit. If Adrian Inc. had provided the realty services and sold the units, Capital City would have been allowed \$27,790 as part of its match (sale prices x 7 percent commission).

We interviewed seven of the 14 buyers. The buyers said that the contract realtor provided services such as: ordering credit reports, helping clean-up credit histories,

accompanying buyers on property inspections, and informing buyers of payment amounts. These were essentially the same services that Adrian Inc. was to provide.

Capital City paid the realtor from sales proceeds. The use of sales proceeds for this purpose was not in conformity with Section 725 of the HOPE 2 Guidelines incorporated into the Grant Agreement. Section 725 required sales proceeds to be used to benefit low-income people. Examples included improvements to properties under the program, business opportunities for low-income families, support services for the homeownership program, additional home-ownership opportunities, and other HUD-approved activities.

Capital City's President said HUD designed the HOPE Grant Programs to be flexible, and that Capital City can provide its match in other ways. Further, Capital City's President said he was allowed to pay for contract realty services from sales proceeds.

Capital City informed HUD's Ohio State Office of its intention to use a contract realtor to help sell rehabilitated units. However, Capital City's President did not identify the source of the funds used to pay the contract realtor. He did say that the realtor would not be paid with Grant funds. The Ohio State Office interpreted this statement to mean that Adrian Inc. was going to pay for the contract realtor with its own funds, since Adrian Inc. was to provide the realty services as part of Capital City's match.

HUD's Ohio State Office staff said one reason Capital City was awarded the HOPE 2 Grant was because of Adrian Inc.'s substantial match of in-kind-contributions in the form of realtor services. HUD did not authorize Capital City to substitute a contract realtor for Adrian Inc.'s services.

In conclusion, Capital City did not provide the matching contribution and therefore did not comply with the Grant Agreement. Further, Capital City used sales proceeds to pay for contract realty services. Therefore, \$75,713 less was available for low-income people.

Finding 1

Auditee Comments

The draft states that Capital City improperly used \$75,713 of Hickory Ridge proceeds to pay for realtor services. This statement is incorrect. The \$70,000, not \$75,713, of sales proceeds spent by Capital City was for specific services performed as defined by three contracts.

OIG Evaluation of Auditee Comments

We believe our amount is correct. We determined that the contract realtor was paid \$75,713 from closing statements and canceled checks obtained from the title company. Capital City based its \$70,000 on contracted amounts (\$5000 x 14 units sold), not amounts actually paid.

Auditee Comments

[The draft finding] states that Capital City is required to complete all work items in the Grant application without additional costs. Where as under normal circumstances this might be true, the Hope 2 Grant is by no means a normal circumstance.

OIG Evaluation of Auditee Comments

We disagree with Capital City's implication that it is bound only by the Grant Agreement under what it considers to be normal circumstances. The Grant requirements apply under all circumstances, unless HUD authorizes changes. And Capital City did not request HUD authorization to contract with another realtor.

Auditee Comments

Capital City did inform the HUD office that a contract realtor was going to help sell the rehabilitated units. However, HUD must have misinterpreted when it comes to [who was] paying compensation for [the contract realty] services.

OIG Evaluation of Auditee Comments

After the close out conference, we checked again with HUD's Ohio State Office staff on what Capital City told them. The HUD staff reiterated that the President never told them that Capital City would use sales proceeds. The President only told them that Grant funds would not be used to pay the contract realtor. They assumed that Adrian Inc. was going to pay for the services.

Auditee Comments

Capital City continues to maintain that the HOPE Program is flexible and that the match can be provided in a number of ways. Upon completion of the project, a final accounting will determine any adjustment that may need to be made to the match. By no means is it crucial that Capital City's match be entirely made up of realty services.

OIG Evaluation of Auditee Comments

The HOPE 2 Grant may be flexible. Capital City, however, had agreed to provide specific realty services to fulfill its match requirements. Capital City cannot disregard that requirement and decide on its own what services it will substitute for the match. Furthermore, Capital City's substantial in-kind contribution was one of HUD's reasons for awarding the Grant to Capital City.

Auditee Comments

Please be aware that all Adrian Inc. receives is a nominal management fee and fair rent for needed office space. Further, Charles L. Adrian receives only \$1,169.47 in total each 2-week pay period. This salary of \$30,000 is nominal and should be more. It is obvious that we are dedicated, love the work and the expected results, and are working for a pittance. The point is that at no time are there any funds, fees, profit, or anything coming from the grant or any other source to Adrian, Inc. or Charles L. Adrian. No one could assume Adrian Inc. would pay for anything.

OIG Evaluation of Auditee Comments

We did not question the reasonableness of the salary paid Capital City's President, nor his and his staff's dedication. We do note, however, that Capital City benefits to the extent that sales prices exceed costs. In addition, Adrian Inc. is expected to earn income for managing the project after sale of the units.

Auditee Comments

The fact of the matter is that grant funds were not used to pay for these services. Sales proceeds were used and consistent with Section 725; since the monies were delegated to assist with the project, they were properly allocated.

Finding 1

The agreements that were put in place with [the contractor realtor's identity-of-interest firms] directly resulted in our being able to market to the target identified by the Grant. It is our feeling that by subscribing to these services we not only were able to sell 14 units, we were also able to contribute to an increase in the quality of life for these grant participants by affording them the luxury of homeownership. Payment for these services is allowed under the grant.

OIG Evaluation of
Auditee Comments

The Agreement restricts the use of sales proceeds for the benefit of low-income people. Using the proceeds to pay for realtor services did not benefit low-income persons.

The contract realtor may have had some success in selling units. But, the realtor provided essentially the same services Adrian Inc. was to provide as part of its match. These services included obtaining financing for potential buyers and cleaning up their credit histories. Capital City itself originated in its application the requirement that Adrian Inc. would provide realty services as part of Capital City's match.

Auditee Comments

Whereas HUD [OIG] states that Capital City received more points because of the match, it is hard to imagine that anything associated with the realty services were normal. We may have received more points because of the match, but the additional work supports both the additional points as well as the additional expense. What HUD fails to understand is that there are three parts to closing these deals: finding buyers, training and counseling, and finding a lender. We have worked hard to market Hickory Ridge and will continue.

OIG Evaluation of
Auditee Comments

In the final analysis, Adrian Inc. did not provide the match as specified in the Grant Agreement and spent \$75,713 of sales proceeds without HUD approval.

Auditee Comments

There continues to be a lack of understanding on HUD [OIG's] part of what normal realty services consist of. Capital City had the units listed with another realtor with

absolutely no movement. Several lenders had been contacted with virtually no commitments for financing. The services provided by the realtor, mortgage brokerage, and consulting company were far from the norm. Had these been considered "normal" loans, anyone would have been able to make them. This is a hard sell property and as such requires a technician dedicated to and experienced with the constituency to get the deals done. We needed that, and employed it only because there was no other way to secure sales.

The draft states that the seven buyers interviewed said that the realtor provided no counseling or training other than that which is considered normal realty services. Capital City believed the mere fact that these deals got closed is evidence enough that the services were performed. For instance, the services of B and C lenders [lenders for borrowers who do not qualify as high grade borrowers] had to be secured, but even for those lenders, some credit issues had to be resolved. And, realty services had to have been performed or the loans would not have closed. Capital City assisted the realtor in every way that we could, but ultimately it was the expertise of the contracted companies that provided the program with homeowners.

OIG Evaluation of Auditee Comments

Selling the units may have been more difficult than Capital City's President anticipated, and the contract realtor had success in selling units. A key was the contract realtor's ability to obtain financing for the buyers and to understand the market.

The comments ignore two critical points. First is the fact that Adrian was going to provide realty services as a match, influenced the awarding of the Grants to Capital City. Second, the contract realtor provided essentially the same services that Adrian was to provide.

Recommendations

We recommended that the Director of HUD's Ohio State Office's Multifamily Housing Division, requires:

- 1A. Capital City to reimburse the HOPE 2 Program for the \$75,713 of ineligible costs paid for realty services.

- 1B. Allow Capital City a seven percent match of the unit sales prices once Capital City has repaid the \$75,713 to the HOPE 2 Grant Program.

If Capital City does not pay back the HOPE 2 Grant for ineligible costs totaling \$75,713, the Director of the Multifamily Housing Division should:

- 1C. Consider imposing administrative sanctions to the full extent of the law.

Capital City Charged Unsupported and Ineligible Costs to the HOPE 1 and HOPE 2 Grants

Capital City charged inadequately supported and ineligible costs totaling \$42,053 to the HOPE 1 and HOPE 2 Grants. It also overcharged the Grants for an undeterminable amount of salaries and related costs. The Grant Agreements require costs charged to the Grants to be reasonable, supported, and eligible. Capital City had ineffective management oversight that allowed unsupported and ineligible costs to be charged to the Grant Programs. Because of these incorrect charges, Capital City had less Grant funds to spend on eligible activities for the benefit of the intended beneficiaries, low-income persons.

Grant Agreements include Circular A-110 and A-122 and Program Guidelines

Both the HOPE 1 and HOPE 2 Grant Agreements incorporated the Grant Applications and the January 14, 1992 Program Guidelines. The Program Guidelines stated that the grantee must comply with Office of Management and Budget Circular A-110, Grants and Cooperative Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations; and Circular A-122, Cost Principals for Nonprofit Organizations (Section 510).

Specific requirements are discussed in the appropriate subsections of the finding.

Unsupported and ineligible costs charged to Grants

Capital City charged \$42,053 of inadequately supported and ineligible costs to the Grant Programs: \$35,227 was inadequately supported and \$6,826 was ineligible. The following schedule shows the unsupported and ineligible costs for each Grant.

Description	Amounts Overcharged		
	HOPE 1	HOPE 2	Totals
Unsupported Costs:			
Equipment Rentals	\$ 8,523	\$12,567	\$21,090
Consulting services	12,130		12,130
Other	_____	<u>2,007</u>	<u>2,007</u>
Total unsupported	<u>\$20,653</u>	<u>\$14,574</u>	<u>\$35,227</u>
Ineligible costs:			
Video		\$ 3,356	\$ 3,356
Duplicate payment		1,970	1,970
Salaries	\$ 1,250		1,250
Gift for Trustee	<u>250</u>	_____	<u>250</u>
Total ineligible costs	<u>\$ 1,500</u>	<u>\$ 5,326</u>	<u>\$ 6,826</u>
Total unsupported and ineligible costs	<u>\$ 22,153</u>	<u>\$ 19,900</u>	<u>\$42,053</u>

Unsupported costs of \$35,227 charged to HOPE Grants

Capital City charged the HOPE Grants \$35,227 for inadequately supported costs: \$20,653 to HOPE 1 and \$14,574 to HOPE 2.

Capital City charged the Grants an estimated \$21,090 for inadequately supported equipment rentals. We calculated the overcharge based on a pro rata share of the total indirect costs. The equipment consisted of computers, software, desks, a phone system, filing cabinets, and a postal meter.

We requested Capital City to provide supporting documentation for the costs and acquisition dates of the equipment. In response, Capital City provided us a list of office furnishings showing a replacement value totaling \$65,305. Capital City did not provide documentation to support the amounts of the replacement values shown on the list. Further, the list did not show the acquisition costs, acquisition dates, or the useful lives of the equipment. Therefore, we could not determine the amount of the equipment rental that should have been charged by Capital City.

Capital City did not adequately support Adrian Inc. consulting fees

Capital City paid Adrian Inc. \$12,130 for consulting services at Poindexter Towers. Capital City did not document the basis for awarding the sole-source contract and for paying Adrian Inc., as required. Further, the invoices did not show the times and dates of the consulting services provided.

Circular A-110 states that all procurement shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. Circular A-110 also states that procurement records must justify sole-source contracts and that sole source contracts over \$5,000 are subject to prior approval of the Federal sponsoring agency (Attachment 0, paragraphs 3.b. and 3.c.(6)).

At the closeout conference, the President said he switched from a salary to a contract fee at the same rate as his salary. He did it for personal reasons. He said he does not have records showing what he did during that time, but he would try to provide some documentation.

The remaining \$2,007 in unsupported costs consisted of: \$1,000 paid to Capital City, \$807 paid to Rescue Rooter, and \$200 in cash for the President of Adrian Inc. and Capital City. No invoices or other documents describing the services provided were in Capital City's files to support the payments. Without adequate support, we could not determine whether the amounts charged benefited the HOPE activities.

Excess salary costs charged to the Grants

Capital City incorrectly charged one employee's total salary to the HOPE Grants although the employee also worked on non-HOPE activities. The employee earned about \$22,500 annually. Indirect costs were allocated to the Grant based on the salary costs. Thus, excessive salary charges caused an excessive allocation of indirect costs. Because of the lack of accurate records we were not able to determine the amount of the overcharges. Circular A-122 states time reports must reflect actual activity (Attachment B paragraph 6.1.(2)(a)).

Ineligible costs of \$6,826 charged to the HOPE Grants

Capital City charged ineligible costs totaling \$6,826 to the HOPE Grants: \$1,500 to HOPE 1 and \$5,326 to HOPE 2.

The \$6,826 of ineligible costs included \$3,356 in excess charges for a video tape production. The video promoted Capital City and four projects, the HOPE 1 and 2 Implementation Grants, the Rosa Parks HOPE Planning Grants and a non-HOPE project. If the total production costs of \$13,426 had been split equally, each project would have been charged \$3,356. The two HOPE Implementation Grants would have been charged a total of \$6,712. However, Capital City charged \$10,070 to the HOPE 1 and 2 Grants, an excess charge of \$3,356. Capital City correctly charged \$3,356 to Rosa Parks, but charged nothing to the non-HOPE project.

Besides the videotape, Capital City charged the Grants \$1,970 for a duplicate payment for Hickory Ridge rehabilitation, \$1,250 for salaries paid to a construction manager on a non-HOPE project, and \$250 for a gift to a Capital City Trustee.

Capital City's ineffective internal controls allowed ineligible and inadequately supported costs to be charged to the HOPE Grants

Capital City charged ineligible and inadequately supported costs to the HOPE Grants because of the lack of sufficient management oversight. Proper management oversight would have detected whether disbursements were adequately supported, the awarding of a sole source contract was documented, time records were maintained, and costs were eligible.

Because Capital City charged \$42,053 of inadequately supported and ineligible costs to the Grants, fewer funds were available to carry out the HOPE Grants' activities for low-income persons.

Auditee Comments

[Capital City submitted a response from its fee accountant regarding the rental equipment charges. The fee accountant said the following]. Adrian Inc. provided a list of equipment The total replacement cost purchase of the equipment was more than \$65,000. The office equipment was used freely by Capital City personnel during the entire Grant period under examination, March 29, 1993 to August 31, 1995. Equipment rent charged during this period

totalled \$750 x 29 months = \$21,750. HUD is alleging that \$21,090 of this amount is ineligible and \$660 is the reasonable rent for this equipment for a period of 29 months.

In the absence of available historical cost records, it is an acceptable practice to utilize fair market value as established by appraisal to document the reasonable value of equipment.

OIG Evaluation of
Auditee Comments

We did not state or imply that the equipment costs were ineligible and that Capital City should be allowed \$660 for equipment rentals. We stated only that the equipment rentals totaling \$20,090 were not adequately supported.

We know of no provisions in OMB Circular A-110 or other Federal requirements permitting the use of fair market value as a basis for determining the reasonableness of equipment rental charges. The documentation supplied by Capital City does not provide a basis for determining the reasonableness of the \$750 a month charged for equipment rental.

Auditee Comments

In addition to the fee accountant's response, I have also included a quotation from a leasing company further supporting the appropriateness of the charge. [The leasing company stated the following]. Based on a \$65,000 value replacement costs, we will be willing to rent the equipment discussed to you for \$1,116 per month.

OIG Evaluation of
Auditee Comments

Neither Capital City nor the leasing company provided any information for determining the basis of the replacement value of \$65,000. We reiterate that replacement value is not a basis for supporting the reasonableness of rental costs.

Auditee Comments

[Capital City said it understood Circular A-110 required open and free competition and that HUD approval was necessary for the sole-source consulting contract.] Prior to the consulting contract Mr. Adrian was being paid a salary for directing the implementation of the HOPE Grant. The contract allowed payment for the same amount as the salary

had provided. The total compensation for this short period was equal to the salary. There was no harm done and none intended.

OIG Evaluation of
Auditee Comments

Capital City still did not provide any additional documentation to support the dates and times Mr. Adrian held consulting meetings. Further, Capital City did not justify entering a sole-source contract for the consultant contract.

Auditee Comments

The \$1,000 to [Capital City] is currently unsupported. However, the work was done. In the event Capital City cannot provide appropriate documentation, the monies in question will be returned to the grant.

OIG Evaluation of
Auditee Comments

We agree with Capital City's proposed removal of unsupported costs from the Grant Program, if Capital City cannot provide appropriate documentation.

Auditee Comments

The \$807.50 to Rescue Rooter was for the replacement of a toilet and sump pump at Hickory Ridge. Enclosed please find the proper documentation.

OIG Evaluation of
Auditee Comments

A review of the documentation showed the invoice to be for maintenance and not rehabilitation. Consequently, Capital City should have charged the cost of the repairs to the Hickory Ridge operating account and not to the HOPE 2 Grant.

Auditee Comments

There is no adequate documentation for the \$200 stipends paid for landscaping at Hickory Ridge. There is no doubt that the service was performed. Since we do not have timecards for this date we will reduce the next Hickory Ridge drawdown.

OIG Evaluation of
Auditee Comments

We agree with Capital City's proposed action of removing the \$200 from the Grant records.

Auditee Comments

In addressing the \$3,356 overcharge for the video tape production, the video producer has determined the amount of \$1,115.07 represents a fair apportionment of the production monies for the Lincoln Theater and Rosa Parks segments of the video. Capital City will reduce the next Hickory and Poindexter drawdown by the appropriate amounts.

OIG Evaluation of
Auditee Comments

We disagree with the producer's determination. The producer's estimates were based on the actual video time showing the Lincoln Theatre and Rosa Parks projects. He attributed none of the fixed costs of the production and the time benefiting all projects to the Lincoln Theatre and Rosa Parks projects. After the adjustment, the HOPE 1 and HOPE 2 Grants would still be overcharged.

Auditee Comments

Responding to the duplicate payment for Hickory Ridge rehabilitation, it should be noted that this entry was booked to the Grant but only drawn on once. Capital City will be making an adjusting entry to remove the second entry from the Grant records.

OIG Evaluation of
Auditee Comments

We agree with Capital City's proposed action to remove the cost from the Grant.

Auditee Comments

The \$1,250 cited in the draft finding for salaries paid for a non-HOPE project's construction manager was incorrectly charged to the HOPE 1 Grant. The Financial Manager will reduce the next Poindexter drawdown for the rehab line item by the appropriate amount.

OIG Evaluation of
Auditee Comments

We agree with Capital City's proposed action to remove the cost from the Grant.

Auditee Comments

The \$250 cited as a gift for a Capital City Trustee was actually a retirement party held in honor of the Trustee. This charge was inadvertently applied to the Grant in error. The Financial Manager will reduce the next Hickory drawdown for the appropriate amount.

OIG Evaluation of
Auditee Comments

We agree with Capital City's proposed action to remove the cost from the Grant.

Auditee Comments

Capital City has estimated that the Grants were overcharged a total of 16 hours per bi-weekly pay period for \$190.37 for payroll and taxes. Since the inception of the Grants, the total charge is \$14,658.49 through March 1996.

During February and March 1996, the Financial Manager conducted a time study and determined that a total of 173 of her hours were worked on the Grants. Forty-five hours a month were charged for her time. Therefore, 83 hours will be charged back to the Grant for February and March, 1996. From the beginning, April 1994, the Financial Manager has determined that, conservatively, she has worked a minimum of 65 hours per month on Grant-related activities. However, since October 1995 it is clear that an additional 21.5 hours per month has been required to meet the demands of the audit. The purpose of this paragraph and these calculations are to rectify two situations: (1) the overpayment of one employee's salary as you mentioned in your letter of \$14,658.49, and (2) the other is to show the amount that Adrian Inc. undercharged for the accounting person's compensation totaling \$15,225.00 from April 1994 through March 1996.

OIG Evaluation of
Auditee Comments

We agree that one employee had been overcharged to the Grants. However, Capital City did not explain how it determined that 16 hours per pay period was the appropriate adjustment from the inception of the Grants. Further, we do not agree that Capital City can charge the Financial Manager's salary to the Grants for 1994 and 1995 without time records. OMB Circular A-122 states that payroll costs must be supported by accurate time records.

Auditee Comments

In response to the statement that Capital City's ineffective internal controls allowed ineligible and inadequately supported costs to be charged to the HOPE Grants, I believe that the Inspector General's Office is making a broad-based statement based on very little evidence. Given the thousands of entries, purchase orders, checks, balancing exercises, to name a few, I feel that our staff, given its size has done a Herculean job of maintaining the integrity of the grant. The mistakes cited have been duly noted and procedures implemented to prevent future errors. Of significance is that the President of Capital City will review and approve all journal entries prior to being booked.

**OIG Evaluation of
Auditee Comments**

An improved system of internal controls may have determined that Capital City needed a better review of disbursements to ensure that all disbursements were supported adequately and charged to the proper accounts. An improved system of internal controls would have also ensured that all activities benefiting from purchases were charged the appropriate amounts, and not charging all such cost to the HOPE Grants. An improved system of internal controls would have determined that sole-source purchasing needed to be justified and proper approval obtained in advance.

Recommendations

We recommend that the Director of the Ohio State Office's Public Housing Division requires Capital City to take the following corrective actions:

- 2A. Provide adequate support for the \$20,653 of undocumented costs charged to the HOPE 1 Grant program. If adequate documentation cannot be provided, Capital City should be required to repay the Grant program. These costs include the following:
- Office equipment rental, \$8,523; and
 - Consulting services, \$12,130.

- 2B. Repay the estimated \$1,500 of ineligible cost to the HOPE 1 Grant. These costs include the following:
- Salaries for a construction manager at a non-HOPE project, \$1,250; and
 - A gift to a Capital City Trustee, \$250.
- 2C. Document the adjustments made to the HOPE 1 Grant for unsupported salary costs and the associated indirect costs.

We recommend that the Director of the Ohio State Office's Multifamily Housing Division requires Capital City to take the following corrective actions:

- 2D. Provide adequate support for the \$14,574 of undocumented costs for the HOPE 2 Grant program. If adequate documentation cannot be provided, Capital City should be required to repay the Grant program. These costs include the following:
- Office equipment rental, \$12,567;
 - Other unsupported costs, \$2,007;
- 2E. Repay the estimated \$5,326 of ineligible costs to the HOPE 2 Grant. These costs include the following:
- Video production, \$3,356; and
 - Duplicate payment, \$1970.
- 2F. Document the adjustments made to the HOPE 2 Grant for unsupported salary costs and associated indirect costs.

Capital City Charged Hickory Ridge Excess Management Fees

Capital City charged Hickory Ridge, the HOPE 2 project, \$9,849 for excess management fees it paid Adrian Inc. over three years. The Grant Agreement permitted a maximum fee of 5.5 percent of residential income collected. Also, it required the owner to obtain HUD approval for any changes. Contrary to this requirement Capital City and Adrian Inc., identity-of-interest firms, agreed to a 7 percent fee without seeking HUD approval. The President of Capital City and Adrian Inc. said he had forgotten about the management certification limiting the management fee to 5.5 percent.

Grant Agreement limited management fee to 5.5 percent

The HOPE 2 Grant Agreement incorporates the Grant Application and the Management Certification between Capital City and Adrian Inc. The Grant Agreement required Capital City to complete all work items in the Grant Application including services and all things necessary for the performance of program activities set forth in the Application and Agreement (Article II.(a)).

The Agreement further stated that only the HUD Grant Officer had the authority to authorize deviations from the Agreement and the Application. The Grantee was at risk for any unapproved deviations and shall bear all costs related to the deviations (Article II.(c)).

On May 15, 1992, Capital City and Adrian Inc. officials agreed to a management certification that was incorporated into the Grant Agreement. It required the parties to execute a Management Agreement that limited Adrian Inc.'s management fee to 5.5 percent of residential income (Paragraph 1). The Certification also required the owner to submit a new Certification to HUD before authorizing a management fee different from the 5.5 percent authorized in paragraph 1 (Paragraph 10).

Management fee increased to 7 percent without HUD approval

On June 3, 1993, Capital City and Adrian entered into a Management Agreement calling for a management fee of 7

Finding 3

percent of gross collections: Section 8 rent payments, rental income, and income from other sources such as coin-operated laundry equipment.

Capital City did not submit a revised Certification with the higher management fees to HUD, as required. The President of Adrian and Capital City said he had forgotten that the Management Certification limited the management fee to 5.5 percent.

Hickory Ridge
overcharged \$9,849 in
management fees

Because of the additional 1.5 percent management fee, Capital City charged Hickory Ridge excessive management fees of \$2,342 in 1993; \$3,929 in 1994; and \$3,578 in 1995:

	<u>1993</u>	<u>1994</u>	<u>1995a></u>
Gross income	\$156,160	\$261,934	\$255,722
Approved fee rate	<u>.055</u>	<u>.055</u>	<u>.055</u>
Fee earned	\$ 8,589	\$ 14,406	\$ 14,062
Management fee charged	<u>10,931</u>	<u>18,335</u>	<u>17,640</u>
Excess fee	<u>\$ 2,342</u>	<u>\$ 3,929</u>	<u>\$ 3,578</u>

a> Amounts are as recorded in Capital City's general ledger as of December 31, 1995.

For the three-year period, Capital City overcharged Hickory Ridge \$9,849 for the excess management fees paid to Adrian.

Auditee Comments

Regarding the "excess management fee" and reference to the [Management Certification], it clearly states fees: 5.5 percent of residential income. Page 2 [of the Certification] further analyzes the fee to be 5.5 percent of monthly gross income of \$37,335, for a monthly fee of \$2,053.42. This calculated income was based on occupancy of 90 percent (96 units, 87 occupied) which was correct at the time of the

survey was completed [about the time of application]. At the time of acquisition, occupancy was 55 percent (96 units, 54 occupied). June 3, 1993 [was the] date the agreement between Adrian Inc. and Capital City for a 7 percent management fee [was signed]. This is the fee (7 percent) charged since that date. You are correct to request Adrian Inc. to pay the amount over 5.5 percent to the Hickory Ridge operating account.

Adrian Inc. has conformed to your recommendations and has paid the correct amount, calculated (as per audits) to be \$6,513.70.

OIG Evaluation of
Auditee Comments

Capital City agrees that it incorrectly charged a 7 percent fee and that the correct fee should have been 5.5 percent. However, it calculated the overcharge as \$6,514 compared to our \$9,489, a difference of \$2,975.

We stand by our calculation. Capital City determined its calculation of fees paid based on unadjusted general ledger balances. We based our calculation on amounts in the certified financial statements submitted to HUD and the certified public accountant's supporting working papers.

Auditee Comments

Please accept this letter as a request to increase, retroactively, the management fee from 5.5 percent to 7 percent. Please forward a copy to the HUD department involved for their consideration.

However, if the request is granted, please allow the refund of our returned payment as soon as possible.

Other management companies would require at least 8 percent to manage, but the original agreement of 5.5 percent is correct. The fact is, it was unintentionally overlooked.

OIG Evaluation of
Auditee Comments

We have forwarded the request for a fee increase to officials in HUD's Ohio State Office for consideration and action. We did not express an opinion on the request.

Recommendations

We recommend that the Director of the Ohio State Office's Multifamily Housing Division requires Capital City to take the following corrective actions:

- 3A. Pay the \$9,849 in excess management fees to Hickory Ridge.
- 3B. Pay to Hickory Ridge any excess management fees charged since December 31, 1995.
- 3C. Certify that it will limit fees to the HUD-approved rate specified in the Management Certification.

Internal Controls

In planning and performing our audit we considered internal control systems of the management of Capital City Community Urban Redevelopment Corporation, to determine our auditing procedures and to provide assurance on internal control. Internal control is the process by which an entity obtains reasonable assurance on achievement of specific objectives. Internal controls consist of interrelated components, including integrity, ethical values, competence and the control environment that includes establishing objectives, risk assessment, information systems control procedures, communication, managing change and monitoring.

Relevant Internal Controls

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

- Management philosophy and operating style;
- Accounting system and controls;
- Segregation of duties;
- Management monitoring methods.

A significant weakness exists if internal controls do not give reasonable assurance that the entity meets goals and objectives; that use of resources is consistent with laws, regulations and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Significant Weaknesses

Based on our review, we concluded that the following items were a significant weaknesses:

- Management monitoring methods.
The lack of management oversight allowed \$42,053 of improperly supported and ineligible cost to be charged to the HOPE 1 and HOPE 2 Grants (see Finding 2).

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Follow Up On Prior Audits

This was the first OIG audit of Capital City Community Urban Redevelopment Corporation. Capital City's last independent audit was for the year ended December 31, 1994. That report contained no findings.

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Schedule of Ineligible and Unsupported Costs

<u>Recommendation Number</u>	<u>Type of Questioned Costs</u>	
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>
1A	\$75,713	
2A		\$20,653
2B	1,500	
2D		14,574
2E	5,326	
3A	9,849	
TOTALS	\$92,388	\$35,227

- 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 amounts charged to a HUD-financed or insured program or activity whose eligibility cannot be determined at the time of the audit since such costs are not supported by adequate documentation or there is a legal or administrative determination on the eligibility of the costs. These costs require a future decision by HUD program Officials.)