OFFICE OF AUDIT
REGION 9
LOS ANGELES, CA

The City of Pomona, CA

Neighborhood Stabilization Program

2014-LA-1006

SEPTEMBER 25, 2014

Issue Date: September 25, 2014

Audit Report Number: 2014-LA-1006

TO: William G. Vasquez, Director, Office of Community Planning and Development, Los Angeles, 9DD

Dane Narode, Associate General Counsel, Program Enforcement, CACC

//SIGNED//

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region 9, 9DGA

SUBJECT: The City of Pomona, CA, Did Not Administer Its Neighborhood Stabilization Program in Accordance With HUD Rules and Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the City of Pomona's Neighborhood Stabilization Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.

September 25, 2014

The City of Pomona, CA, Did Not Administer Its Neighborhood Stabilization Program in Accordance With HUD Rules and Requirements

Highlights

Audit Report 2014-LA-1006

What We Audited and Why

We audited the City of Pomona's Neighborhood Stabilization Programs (NSP1 and NSP3). We initiated the audit because of a hotline complaint with concerns regarding the administration of program funds. Our objective was to determine whether the City administered its NSP funds in accordance with applicable U.S. Department of Housing and Urban Development (HUD) rules and requirements. Specifically, we wanted to determine whether the City monitored its subrecipients and ensured that NSP expenditures were adequately supported and eligible.

What We Recommend

We recommend that HUD require the City to (1) repay $78,155 in ineligible costs, (2) support or repay $584,148 in unsupported costs, and (3) establish and implement better controls for monitoring HUD-related costs and prevent future instances of conflicts of interest. We also recommend that HUD's Associate Counsel for Program Enforcement pursue civil remedies, civil money penalties, or other administrative action, as appropriate, against the City, the developer, and the councilmember for their involvement in the ineligible use of NSP funds because of conflicts of interest.

What We Found

The City did not operate its NSP in accordance with HUD rules and requirements. While we did not identify problems with the sampled NSP3 funding activities, we found that the City used $42,129 in NSP1 funds for duplicate profit and overhead costs, ineligible rehabilitation expenses, and ineligible developer's fees. In addition, the City was unable to support the eligibility of $584,148 in NSP1 expenses. The problem occurred because the City did not follow HUD rules and requirements or its own internal agreements and policies and procedures. As a result, the City paid $626,277 in ineligible and unsupported NSP1 funds that could have been used to further the City's objective of providing affordable housing in target areas affected by the housing crisis.

The City allowed a conflict-of-interest situation when it allowed a City councilmember's affiliated developer entity to participate in the City's NSP. This condition occurred because the City ignored the terms of its executed agreements, such as its disposition and development agreements that prohibited such conflicts. In addition, the City did not understand HUD's conflict-of-interest regulations. The arrangement allowed the developer to inappropriately gain insider information and receive $36,026 in NSP funds for improper developer's fees and overhead and profit.

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BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program (NSP) was established for the purpose of stabilizing communities that have suffered from foreclosures and abandonment. The goal of the program is being realized through the purchase and redevelopment of foreclosed-upon and abandoned homes and residential properties. NSP1, a term that references the NSP funds authorized under Division B, Title III, of the Housing and Economic Recovery Act of 2008 (HERA), provides grants to all States and selected local governments on a formula basis. NSP3, a term that references the NSP funds authorized under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, provides a third round of neighborhood stabilization grants to all States and select governments on a formula basis.

The City of Pomona, CA, was awarded more than $3.5 million (NSP1) and $1.2 million (NSP3) in funding through the U.S. Department of Housing and Urban Development's (HUD) NSP. As of June 30, 2013, HUD's Disaster Recovery Grant Reporting[1] system performance reports showed that the City had drawn down more than $3.1 million in NSP1 funds. As of December 30, 2013, the same system showed that the City had drawn down $951,047 in NSP3 funds. The City used its NSP funds for two primary activities, plus administration:

1. Establish financing mechanisms for purchase and redevelopment of foreclosed-upon homes and residential properties, including such mechanisms as soft seconds, loan-loss reserves, and shared-equity loans for low- and moderate-income home buyers.
2. Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon to sell, rent, or redevelop such homes and properties to assist households below 120 percent area median income.
3. Provide administration and planning in an amount not to exceed 10 percent of the total grant amount, plus 10 percent of program income for program planning and administration.

The objective of our audit was to determine whether the City administered its NSP1 and NSP3 funds in accordance with applicable HUD rules and regulations. Specifically, we wanted to determine whether the City monitored its subrecipients and ensured that NSP expenditures were adequately supported and eligible.

[1] The Disaster Recovery Grant Reporting system was developed by HUD's Office of Community Planning and Development for the Disaster Recovery Community Development Block Grant program and other special appropriations, including NSP. Data from the system is used by HUD staff to review activities funded under these programs and for required quarterly reports to Congress.

RESULTS OF AUDIT

Finding 1: The City Did Not Expend Its NSP1 Funds in Accordance With Requirements

The City did not expend its NSP1 funds in accordance with requirements. Specifically, it paid $42,129 for duplicate profit and overhead costs, ineligible rehabilitation expenses, and ineligible developer's fees. In addition, it was unable to support the eligibility of $584,148 in program expenses. The problem occurred because the City did not follow HUD rules and requirements or its own agreements and monitoring policies and procedures. In addition, the City used a review process to reimburse for costs without obtaining needed supporting documentation. As a result, it incurred $626,277 in ineligible and unsupported NSP1 costs that were not available to further its objective of providing affordable housing in target areas affected by the housing crisis.

The City Reimbursed for Ineligible Expenses

The City approved and reimbursed developers for $42,129 in ineligible expenses (see appendix D). These ineligible expenses included

- $36,773 in ineligible profit and overhead,
- $2,008 in ineligible rehabilitation expenses, and
- $3,348 in ineligible developer fee based on ineligible costs.

Ineligible Profit and Overhead Totaled $36,773

Contrary to NSP Policy Alert - Guidance on Allocating Real Estate Development Costs in the Neighborhood Stabilization Program**,** updated September 16, 2011 (see appendix C), the City approved payments of developer's fees and profit and overhead. Specifically, two developers received $36,395 in developer's fees and $36,773 in profit and overhead for the rehabilitation of two NSP properties. The profit and overhead are already covered by the developer's fee. Accordingly, the developers receiving both developer's fees and profit and overhead were double-dipping, which should not have been allowed. As a result, we determined that $36,773 in profit and overhead charged to the program was ineligible.

Ineligible Rehabilitation Expenses Totaled $2,008

Contrary to Federal Register, Vol. 75 64332, paragraph H (see appendix C), the City used program funds to reimburse developers $2,008 in expenditures not allowed under the NSP. In one transaction, the developer submitted an invoice for $5,750 for lead abatement services provided by a third-party vendor. However, the third-party vendor invoice for the services was for only $4,750 and the developer had submitted an invoice to the City for reimbursement that included a $1,000 markup ($5,750 – $4,750). The $1,000 markup was an ineligible NSP expense. The City also paid $875 in duplicate asbestos survey costs. In addition, it reimbursed developers $100 for miscellaneous items, such as candies, snacks, and lemonade, as well as $33 for additional garbage disposals, which were also ineligible NSP expenses.

Ineligible Developer's Fees Totaled $3,348

The City reimbursed the developer $38,781 for ineligible rehabilitation costs. According to the executed disposition and development agreements between the City and developers, developer's fees are based on an agreed-upon percentage[2] of the total acquisition and rehabilitation costs of each property in the possession of the developer. Since we identified $38,781 in ineligible rehabilitation costs, we prorated the original amount of developer's fees earned to total $3,348 in ineligible developer's fees.

One of the two developers received a developer's fee of $20,395. It also claimed $21,388 in profit and overhead, which was determined to be an ineligible program expense. As a result, we prorated the original amount of the developer's fee by 7 percent, the approved percentage in its agreement, to arrive at a total ineligible developer fee of $1,497.[3]

The second developer received a developer's fee of $16,000. It also claimed $15,385 in profit and overhead, which was determined to be an ineligible program expense. As a result, we prorated the original amount of developer's fees earned to arrive at a total ineligible developer's fee of $1,851.[4]

[2] Two developers received a flat fee of $16,000 and not a percentage of the acquisition and rehabilitation costs.
[3] $97,831 project cost - $21,388 ineligible profit and overhead = $76,443 // $193,527 total acquisition cost + $76,443 eligible rehabilitation costs = $269,970 total acquisition and eligible rehabilitation costs x 7% = $18,898 correct amount of developer fee. The City paid the amount of $20,395 in developer's fees. Based on the adjusted amount of developer's fees, there was an overpayment of $1,497 ($20,395-$18,898).
[4] $16,000 developer's fee / $137,536 in total project costs = 12% // 12% x $15,425 in ineligible costs = $1,851.

The City Reimbursed for Unsupported Expenses

The City incurred $584,148 in program expenses that it could not support (see appendix D).

There Were No Records To Support Rehabilitation Expenditures of $566,811

The City reimbursed more than $1.1 million in rehabilitation expenses incurred at nine NSP-funded properties. However, neither the City, the developers, nor the contractors could provide documentation to support the eligibility $566,811 in rehabilitation expenses in accordance with 24 CFR (Code of Federal Regulations) 570.506(h) (see appendix C).

Contrary to HUD's and its own requirements, the City did not ensure that developers' or contractors' expenses that it submitted were properly supported and eligible. Instead, the City approved costs based on a percentage of completion method. For instance, when the developer or contractor requested a rehabilitation progress payment, the City received a continuation sheet indicating the percentage of rehabilitation completed. While conducting site inspections, the City looked at the progress of the rehabilitation onsite and compared it to the continuation sheet for discrepancies. The rehabilitation progress payment request forms did not include documentation that supported incurred costs. Instead, this document included only budgeted line item expenses, which the City used to determine the amount to reimburse the developer.

The grantees' use of the percentage of completion method was not the proper method of reimbursement since it provided the developers or contractors the opportunity to earn more profits by incurring more expenses. For instance, one developer's scope of work indicated "re-pipe home with new Type 'L' copper lines" for $5,000 and remove and dispose of existing carpet and install new 6-pound padding and carpeting for $6,800 for property number 7 (see appendix D). However, a site visit revealed that the house may not have been repiped with copper. The homeowner explained that 2 months after moving into the property, his family experienced two leaks from pipes he believed to be galvanized, not copper as stated in the scope of work. The developer installed only 727 square feet of carpeting upstairs. The living area downstairs totaled about 800 square feet, of which the hardwood floor was retained and not carpeted. The invoices provided by the general contractor showed only $185 and $722, or a total of $907, in expenses for copper and carpet and padding, respectively. However, the developer received reimbursements for the budgeted line items for the repipe and carpet totaling $11,800 ($5,000 + $6,800) and an approved developer fee of 7 percent for approved rehabilitation costs, or $826, for the budgeted line items detailed above.

At the same property, we also found two invoices submitted by the developer and general contractor for the same draw and amount with different descriptions of

work performed. For instance, a developer submitted for reimbursement an invoice of $8,565 (see exhibit 1) stating that work was completed and approved based on the City's inspection. However, this general contractor provided another invoice for $8,565 (see exhibit 2) that showed work completed, which was different from the work stated in the previous invoice (see exhibit 1). During a site visit to the subject property, we showed these documents to City officials and asked for an explanation. However, the City officials could not explain the differences in the documentation that showed the same draw and amount but different work performed at the property.

Description			Amount
Original Scope of Rehab Work	Per original contract	$	8,565.00
Work completed to-date: • Removed existing carpet and padding. Installed new mid-grade carpet with 6# padding. • Re-glazed existing 2nd floor hallway bath tub • Purchase and installed new free-standing stove/range • Installed 4-new light fixtures • Front and rear yard clean up and brush/shrub trimming • Received City Final- see attached City Bldg Job Card			
Total	Invoice Total	$	8,565.00
	Grand Total:	**$**	**8,565.00**

Exhibit 1

DESCRIPTION OF WORK COMPLETED

- Completed the interior prep and painting, per Scope of Work
- Installed missing interior doors and hardware
- Completed the installation of new copper re-pipe (City Bldg permitted attached)
- Repaired exterior siding on west side of dwelling
- Installed new closet shelves and poles to all bedroom closets
- Repaired and painted exterior free standing patio
- Installed two (2) 3 ton A/C condensers
- Removed and disposed of all job related trash and debris

The following is a request for payment in the amount of **$ 8,565.00** includes all labor and materials.

Exhibit 2

Source documentation, such as receipts for materials and labor, are important to show whether items were purchased or rehabilitated and the costs were reimbursed according to the scope of work. Although the City approved the scope of work for each property, it did not require the developers and contractors to support rehabilitation costs before reimbursing them. Therefore, it could not have known which items in the scope of work had been completed and properly reimbursed.

Since the profit and overhead for each property was based on incurred expenses, the developers gained more profit by incurring higher rehabilitation costs. Without requiring developers to provide invoices to support incurred costs, as

required in its policies and procedures and by HUD, the City could not provide assurance that the developers performed the required work and that costs were eligible and supported. Based on a discussion with City personnel, it was a common practice to approve reimbursement of costs using the percentage of completion method instead of invoices. As a result, we determined that the City incurred $566,811 in unsupported program expenses.

Invoices and Receipts of $3,857 Were Illegible

The City provided $3,857 in receipts and invoices from developers or contractors for items used in the rehabilitation work on the NSP-funded properties. The documents appeared to be from vendors such as Home Depot but were illegible; therefore, we could not determine whether the expenses were allowed under the NSP. As a result, we determined that this amount was unsupported.

Total Development Costs of $3,242 Were Unsupported

According to paragraph 2301(d)(3) of HERA, the maximum sales price for a property is determined by aggregating all costs of acquisition, rehabilitation, and redevelopment (including related activity delivery costs, which may include, among other items, costs related to the sale of property (see appendix C). The City sold an NSP property for $228,000 and claimed the total development costs to be $228,892. However, it provided support for only $224,758 and was unable to provide documentation to support the remaining $3,242 ($228,000 – $224,758). Without this documentation, the City may have oversold the subject property to the homeowner by $3,242.

An Unsupported Developer Fee Totaled $10,238

We determined that there were unsupported costs of $573,910. Since developer's fees were based on percentages[5] of acquisition and rehabilitation costs and we determined $573,910 to be unsupported, we prorated the amount of developer's fees to determine unsupported developer's fees of $10,238.

One of the two developers received a developer's fee of $14,139. We determined that there were unsupported costs of $78,933 for the subject property rehabilitated by the developer. As a result, we prorated the original amount of developer's fees of 7 percent approved in its agreement and determined that $2,636[6] of the developer fee was unsupported.

The second developer received a developer's fee of $16,000. We determined that there were unsupported costs of $63,353 for the subject property rehabilitated by

[5] Two developers received a flat fee of $16,000 and not a percentage of the acquisition and rehabilitation costs.

[6] 83,433 total project rehabilitation costs - $78,933 unsupported costs = $4,500 eligible costs // $159,831 acquisition cost + $4,500 eligible costs = $164,331 x 7 percent = $11,503 adjusted developer fee based on unsupported costs // $14,139 paid developer fee - $11,503 adjusted developer fee based on unsupported costs = $2,636

the developer. As a result, we prorated the original amount of developer's fees received of $16,000 and determined that $7,602[7] was unsupported.

Conclusion

While we did not identify problems with sampled NSP3 funding activities, we found that the City did not expend its NSP1 funds in accordance with requirements. Specifically, the City paid $42,129 for duplicate profit and overhead costs, ineligible rehabilitation expenses, and ineligible developer's fees. In addition, it was unable to support the eligibility of $584,148 in program expenses. This condition occurred because the City did not follow HUD rules and requirements or its own agreements and monitoring policies and procedures to ensure that costs were eligible and adequately supported. In addition, the City used a review process that allowed it to reimburse developers or contractors for costs without obtaining supporting documentation. As a result, the City paid $626,277 to developers and contractors, which was ineligible and unsupported under the NSP. These funds could be used to further the City's objective of providing affordable housing in target areas affected by the housing crisis.

Recommendations

We recommend that the Director of HUD's Los Angeles Office of Community Planning and Development require the City to

1A. Repay HUD, using non-Federal funds, $36,773 paid to developers for ineligible profit and overhead costs identified in this report.

1B. Repay HUD, using non-Federal funds, $2,008 paid to developers and contractors for ineligible rehabilitation expenses identified in this report.

1C. Repay HUD, using non-Federal funds, $3,348 paid to developers for ineligible developer's fees identified in this report.

1D. Provide documentation to support the $580,906 ($566,811 + $3,857 + 10,238) in rehabilitation costs identified in this report or repay HUD, using non-Federal funds, for those costs that the City cannot support.

1E. Provide documentation to support the $3,242 in total development costs identified in this report or reimburse the homeowner.

1F. Implement better internal controls such as monitoring to ensure that all incurred community planning and development-related costs are supported, eligible, and reasonable as required by the Office of

[7] $16,000 developer fee / $137,536 in total project costs = 12 percent // 12 percent x $63,353 in unsupported costs = $7,602

Community Planning and Development's rules and requirements and its own executed agreements, rules, and requirements.

RESULTS OF AUDIT

Finding 2: The City Allowed a Conflict-of-Interest Situation

The City allowed a conflict-of-interest situation when it allowed a City councilmember's affiliated developer entity to participate in the City's NSP. This condition occurred because the City ignored the terms of its executed agreements, which prohibited such conflicts. In addition, the City did not understand HUD's conflict-of-interest regulations that prohibit any appearance of associated members' having an interest in the program. The arrangement allowed the affiliated developer to gain insider information and participate in the program. In addition, the developer's ties to the City councilmember allowed the developer to improperly receive $36,026 in NSP funds for developer's fees and profit and overhead.

The City Allowed the Conflict of Interest To Occur

Contrary to its own disposition and development agreements and HUD requirements (see appendix C), the City inappropriately allowed an apparent conflict-of-interest situation to exist when it permitted a councilmember's affiliated developer to participate in the NSP. The councilmember did not remove herself from the decision-making process related to the City's NSP. For instance, the councilmember was present on June 1, 2009, for a board meeting and approved the list of developers to participate in the NSP. One of the approved developers was her affiliated developer entity, yet there was no documentation to show that the councilmember recused herself from the meetings.

The City explained that the councilmember provided a signed disclosure, dated September 1, 2010, and indicated that she served as the president of the affiliated developer, receiving no compensation. However, the City approved the affiliated developer on June 1, 2009, before that disclosure. The councilmember did not sign the disclosure form until 15 months after she had voted to approve the affiliated developer to participate in the program. As a result, the councilmember's affiliation with the developer allowed it to gain insider information regarding the program.

Further, City officials stated that the affiliated developer wanted the councilmember to serve as one of the developer's board members because of the individual's expertise in real estate. In addition, the councilmember had many properties in Pomona, further helping the developer in the targeted area. However, the councilmember was the person responsible for overseeing the developer's NSP projects from the initial drafting of the proposal to signing and executing the agreements with the City and general contractor. The councilmember was also responsible for the bank account and signed all of the

checks on behalf of the developer. Thus, the councilmember was involved in the day-to-day operations of the affiliated developer.

The City Claimed That HUD Was Aware of the Conflict of Interest

The City claimed that it disclosed the conflict of interest to HUD and that HUD was aware of the councilmember's affiliation with the developer. Therefore, the City believed that HUD had approved the arrangement. However, the City stated that the information was conveyed in a phone conversation and not documented. We contacted a former HUD representative to confirm the conversation. The HUD representative stated that the City did not mention the councilmember's involvement with the developer. As a result, the representative questioned the validity of the City's assertion that HUD approved the arrangement. Further, the representative stated that if a councilmember was involved in the NSP, it would have been considered a conflict of interest and not allowable. The City would have needed to obtain formal approval from HUD headquarters to waive the conflict-of-interest prohibition and approve the councilmember to participate in the NSP.

The Developer May Have Received Preferential Treatment

The developer associated with the City's councilmember may have received preferential treatment in the NSP. Specifically, the City did not hold the developer accountable to its executed agreement for rehabilitation as it did with other developers. In addition, the City allowed the developer to participate in the NSP without full-time staff, thereby raising concerns about its capacity as a developer.

The Affiliated Developer Was Given Preferential Agreement Terms

Contrary to the agreement for rehabilitation, there were instances in which property vandalism had occurred but the developer was allowed to seek reimbursement for the costs. In subject property number 5 (see appendix D), the vandalism included stolen wire outlet circuits and a 32-inch exterior door, which resulted in an additional $6,700 in rehabilitation costs to the property. However, the City did not hold the developer responsible for assuming this cost, nor did it deduct the costs from the developer fee. On the other hand, a different, nonaffiliated developer was held responsible for making up $2,400 in costs associated with the vandalism of NSP-funded property number 2 (see appendix D), which resulted in a stolen air conditioning unit.

Conclusion

The City allowed a conflict-of-interest situation when it allowed a City councilmember's affiliated developer entity to participate in the City's NSP. This condition occurred because the City ignored the terms of its agreement prohibiting conflicts of interest that involved City officials' having an interest in the NSP. In addition, the City did not understand the Office of Community Planning and Development's conflict-of-interest regulations that prohibited any appearance of associated members' having an interest in the program. As a result, the councilmember's interest in the developer allowed it to gain insider information and opportunities that other developers would not have. The developer's ties to the councilmember allowed it to improperly receive $36,026 in NSP funds for developer's fees and profit and overhead.

Recommendations

We recommend that the Director of HUD's Los Angeles Office of Community Planning and Development require the City to

2A. Repay HUD, using non-Federal funds, $36,026, paid in developer's fees and profit and overhead to the developer because of the conflict of interest associated with the councilmember.

2B. Implement appropriate controls to prevent future instances of conflicts of interest that involve NSP funds.

We recommend that HUD's Associated General Counsel for Program Enforcement

2C. Determine legal sufficiency and if legally sufficient, pursue civil remedies (31 U.S.C. (United States Code) Sections 3801-3812, 3729, or both), civil money penalties (24 CFR 30.35), or other administrative action against the City, the affected developer, and councilmember for allowing NSP funds to be used for ineligible costs as a result of the conflict of interest.

SCOPE AND METHODOLOGY

We performed our onsite work at the City's offices located at 505 S. Garey Avenue, Pomona, CA, from January to July 2014. Our audit covered the period January 1, 2008, to December 31, 2013, and was expanded to other periods as necessary.

To accomplish our audit objective, we

- Reviewed relevant HUD NSP1 and NSP3 requirements and regulations,
- Reviewed the City's NSP policies and procedures,
- Reviewed executed agreements,
- Reviewed pertinent information from the Disaster Recovery Grant Reporting system,
- Reviewed files and expenditures that pertained to the acquisition and rehabilitation of NSP properties,
- Reviewed board minutes and resolutions,
- Interviewed key personnel from the City and HUD, and
- Conducted site visits to NSP properties.

Initially, we selected a nonstatistical sample of disbursements based on the highest dollar amount for each project from NSP1 and NSP3. Based on the results from the initial review, we proceeded with the audit and selected additional samples to review. Our sample included a review of properties acquired under the acquisition, rehabilitation, and resale of single-family properties or rental units during the grant period.

HUD awarded the City more than $4.7 million in NSP funding. Of this amount, more than $3.5 million was for the NSP1 and $1.2 million was for the NSP3. Our sample review consisted of five developers that rehabilitated and resold or converted to rentals nine properties funded with $2.6 million in NSP1 and NSP3 funds. We reviewed properties from at least one developer selected for the NSP. Further, we selected properties from one developer because of issues of questioned costs identified in a previous audit. We selected another developer due to an apparent conflict of interest that involved a City councilmember.

We determined that computer-processed data generated by the City were not used to materially support our audit findings, conclusions, and recommendations. Thus, we did not assess the reliability of the City's computer-processed data.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Effectiveness and efficiency of program operations – Implementation of policies and procedures to ensure that NSP1 and NSP3 funds are used for eligible purposes.

- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to adequately support program expenditures.

- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure that monitoring and expenditures of NSP1 and NSP3 activities comply with applicable HUD requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The City did not monitor its programs to ensure that funds were used in compliance with HUD requirements (findings 1 and 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	$36,773	
1B	$2,008	
1C	$3,348	
1D		$580,906
1E		$3,242
2A	$36,026	
Total	**$78,155**	**$584,148**

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. In this case, ineligible costs consist of developer's fees paid to the developer because of a conflict of interest, profit and overhead reimbursed to developers, and other expenses not allowed under the NSP.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. In this case, unsupported costs consist of rehabilitation expenses, inclusive of developer's fees and profit and overhead, reimbursed to developers and contractors without required documentation to support incurred development costs.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 1

THE CITY OF
POMONA

Office of the City Manager

LINDA C. LOWRY
City Manager

September 18, 2014

Ms. Tanya Schulze
Regional Inspector General for Audit
Office of Inspector General
U.S. Dept. of Housing and Urban Development (HUD)
611 W. 6th Street, Suite 1160
Los Angeles, CA 90017-3101

Subject: Response to the Draft Audit Report for the Neighborhood Stabilization Program (NSP1 & 3)

Dear Ms. Schulze:

This letter is in response to the Draft Audit Report ("Report") prepared by the US. Housing and Urban Development ("HUD"), Office of Inspector General ("OIG") received on September 4, 2014 for the survey/audit ("Audit") conducted at the City of Pomona ("City" or "Grantee") from February 2014 to July 2014 for the above-named program. This letter responds to the OIG findings. Each response is presented in the order in which they are presented in the Report and outlines the responses by the City regarding these findings. The page numbers in parentheses correspond to the page numbers in the Report.

FINDINGS

1. **Finding 1 – The City Did Not Expend Its NSP1 Funds in Accordance with Requirements (Page 4)**

   A. *The City Reimbursed for Ineligible Expenses – The City approved and reimbursed developers for $42,129 in ineligible expenses (Page 4).*

   (1.) Ineligible Profit and Overhead Totaled $36,773 (Page 4)

   Grantee Response

   Based on Appendix D of the Report, the breakdown of ineligible amounts for the two properties in question is: (a.) $21,388 for property #1 and (b.) $15,385 for property #4. The developers received $36,395 in developer's fees and $36,773 in profit and overhead. The Report indicated that it would be double-dipping if a developer received both developer fees and profit and overhead. Both developers were acting not only as the developer but also as the general contractor for their projects. They both have a general contractor's license and therefore, charged a "profit and overhead" for acting as the general contractor. According to NSP Policy Alerts – "Guidance on Developers, Subrecipients, and Contractors" dated August 27, 2010 and updated on November 16,

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2011, a developer may charge contractor fee or brokerage fee if performing separate services for activity delivery and general administration (page 6 of the Alert). Additional documentation will be provided to indicate the scope of work and various costs associated to performing the roles as a developer verses as a general contractor.
It is a common practice for an entity to act as both the developer and general contractor for a project, and it is a common practice to charge a developer fee for acting under the capacity of a developer, and to charge a separate fee as profit and overhead for acting under the capacity of general contractor. These fees are usually pre-negotiated and are usually a fixed amount or based on a fixed percentage. It is not an ordinary practice to have a breakdown of costs incurred under each capacity. However, the scopes of work for being a developer and general contractor are different and can be defined separately.

Comment 2

(2.) Ineligible Rehabilitation Expenses Totaled $2,008 (Page 5)

Grantee Response

The Report indicated a total of $2,008 ineligible rehabilitation expenses as follows:

a. $1,000 markup for lead abatement services provided by a third-party vendor - **Response**: The $1,000 was not a markup and was supported by additional invoices which will be provided later.
b. A duplicate asbestos cost in the amount of $875 –
Response: The duplicate cost was included in the ledger provided by the developer in an email dated May 26, 2014. However, there was not a duplicate payment made to the developer based on the draw breakdowns.
c. $100 for miscellaneous items:
Response: These items were included in the receipts provided *but were not reimbursed to the developer with NSP funds.*
d. $33 for additional garbage disposals:
Response: It is common that a contractor purchases multiple items in one transaction and therefore the receipt showed multiple units of garbage disposals. However, only the cost for one unit was approved and reimbursed to the contractor.

Comment 3

(3.) Ineligible Developer's Fees Totaled $3,348 (Page 5)

Grantee Response

The amount was derived based on the ineligible costs aforementioned in A(1) and A(2), and should be adjusted based on approved expenses.

Comment 4

B. *The City Reimbursed for Unsupported Expenses (Page 6)*

(1.) There Were No Records To Support Rehabilitation Expenditures of $566,811 (Page 6)

Grantee Response

The Grantee has had the understanding that invoices from contractors would be sufficient as source documentation for payments. This is not only the industry practice in Housing Divisions worked at by Grantee employees, but also an industry standard for

construction and rehabilitation jobs. We believed that HUD requirements for maintaining sufficient documentation of costs incurred was fulfilled – as has consistently been the case with past HUD practices—and the process would be sufficient by conducting a cost reasonableness review plus onsite inspections verifying construction/rehabilitation was completed based on the approved and contracted scope of work. Since the Audit, staff has notified developers and contractors that receipts and invoices directly from vendors would be required. As this appears to be a recent HUD interpretation of the sufficient documentation standard, Grantee will continue to advise vendors of this procedure.

Grantee is working with all of the contractors in obtaining receipts for the $566,811 unsupported expenditures and will provide those to HUD when received.

Comment 5

In the Report (third paragraph on Page 6), it stated that property #7 for which the contractor received payment for copper repiping may not have been repiped with copper. This implication was based on conversations between OIG auditors and the property owner at the time of site visit. **The plumbing work was completed based on the scope of work, and site visits by a Housing Rehabilitation Specialist were also conducted to validate the scope of work was done.** Additionally, a Building Inspector inspected and signed off the plumbing work. We believe that the Report's conclusion is unwarranted and falsely concludes that copper repiping *may* not have been done based on assumptions made by the property owner who was not involved with the original rehabilitation work. As this conclusion accepts the statement of the homeowner (without any evidence to support any actual investigation by the homeowner) and completely disregards the statements of two professional inspectors who did in fact complete actual inspections, the conclusion is on a very weak foundation to make such strong accusations. We respectfully request that this paragraph be eliminated in the final report.

Comment 6

Beginning on the last paragraph on page 6 and continuing on page 7, the Report indicates that a developer submitted an invoice for reimbursement in the amount of $8,565, and later that a general contractor submitted another invoice for the same amount, but the descriptions for work completed were different in the two invoices. The conclusion in the Report is that these amounts were for the same work, effectively billed for twice. Grantee believes such conclusion is false. Grantee believes each of these two invoices are valid and were for two different sets of work completed. We are in the process of verifying these and will provide additional documentation. As the sole basis for the implication in the Report is that the work performed cost the same amount, Grantee requests that this item be stricken from the report unless more definitive evidence to support the accusation is provided.

Comment 7

(2.) Invoices and Receipts of $3,857 Were Illegible (Page 8)

Grantee Response

The City will continue working with the developers and contractors to obtain legible copies of the receipts and will provide those.

(3.) Total Development Costs of $3,242 Were Unsupported (Page 8)

Grantee Response

The $3,242 was for project soft costs. Grantee will provide documentation for soft costs incurred for the subject property.

Comment 8

(4.) An Unsupported Developer Fee Totaled $10,238 (Page 8)

Grantee Response

The amount was derived based on the ineligible costs aforementioned in B(1), B(2) and B(3), and should be adjusted based on approved expenses

Comment 9

C. *Conclusion (Page 9)*

Grantee Response

The City has been following HUD rules and requirements as well as our internal agreements, policies, and procedures. The key discrepancy is found in the term, "source documentation." OIG interpreted "source documentation" as "receipts" while the City interpreted it as "invoices" from contractors. We appreciate HUD and OIG clarifying these issues, and will change the City's policy and procedure once OIG and HUD CPD reach an agreement.

Comment 10

2. **Finding 2 – The City Inappropriately Allowed a Conflict-of-Interest Situation (Page 11)**

A. *The City Allowed the Conflict of Interest to Occur (Page 11)*

Grantee Response

Grantee believes the Report improperly applies 24 CFR 570.611 regarding prohibited conflicts which prohibits persons from having a "financial interest" in a decision made by such person. The Councilmember at issue here had no financial interest in the Developer, a non-profit corporation with a twenty-year history of having rotating leadership among various persons in the community interested in promoting economic development in the community. No evidence exists for the Report to rely upon to support its erroneous contention that the Councilmember had a financial interest. But by mere accusation in the Report, Grantee is now put in the unenviable position of having to disprove the Report's logical fallacy that the situation (financial interest) must be true because the Grantee has not proven it false. The Report does not indicate where the supposed HUD regulation prohibiting "any appearance of associated members' having an interest in the program" is located.

Indeed, this is **NOT** the regulation, as section 570.611 expressly prohibits financial interests and financial benefits, which the Councilmember did not have and did not receive. Further, the regulations allow a process for seeking an exception of a potential conflict of interest, and while such process was not commenced prospectively ahead of participating in the nascent NSP program, the analysis under state law conflicts of interest regulations was performed by the City Attorney at the time the Developer directly

participated in the NSP program by being awarded a contract under the program. (See discussion below). It was then determined that out of an abundance of caution that the file be documented by a letter indicating that indeed such Councilmember had no financial interest in and received no financial benefit through the activities with the Developer.

Comment 11

Further, the statement in the Report's use of the term "allowed" implies that all parties involved were aware of the relationship at issue and knowingly proceeded. By virtue of the letter to file having been written such is simply not the case. To the extent that the Councilmember had knowledge of the association with the developer entity, by virtue of the statements contained in such letter to the file that the Councilmember had no financial interest in the developer entity, the analysis was complete in the Councilmember's mind that no conflict existed and therefore no recusal was necessary. Indeed, in all likelihood had the exception petition pursuant to section 570.611(d) been applied for, it would have been granted. Conversely, had it not been approved, the remedy options would have been recusal from the vote (that passed unanimously and the Councilmember's vote was not required for project approval), a re-do of the vote with conflict thoroughly noted, and/or forfeiture of the non-paid leadership position in a long standing non-profit community benefit corporation.

A more accurate finding –one that casts no improper aspersions and not containing conclusory statements built on misinterpretation of the regulations– is that "A Potential Conflict of Interest Was Not Addressed Through A HUD-Approved Process."

Accordingly, Grantee requests that Finding 2 be removed from the Report, or alternatively that a less inflammatory description of the Finding be used.

As for response to the remainder of the headings and statements under this Finding, Grantee responds as follows:

Comment 12

Again, the heading "The City Allowed the Conflict of Interest to Occur" is conclusory and misstates the unfolding of events by inaccurately portraying the analysis of a non-financial interest as an active event by the Grantee "City". As discussed above, it is Grantee's and the Councilmember's position that no financial interest ever existed between Developer and Councilmember to trigger further analysis, an exemption request under 570.611(d), or to warrant such heading used in the Report.

The first paragraph under the section "The City Allowed the Conflict of Interest to Occur", on Page 11, indicates that the Councilmember participated in the approval of a list of developers qualified to participate in the NSP during a "closed-session" board meeting on June 1, 2009. Such statement is patently incorrect. Although there was a closed session portion of the meeting on June 1, 2009, commencing at 5:30 p.m., the closed-session agenda did not include any items pertaining to NSP. The particular NSP item was agendized and approved during the Regular Business Meeting portion of the City Council Meeting in open/public session beginning at 7:00 p.m., which was evidenced in the publicized agenda and meeting minutes. The motion to approve the list of contractors came as part of a motion to approve participating in the program as a whole; there was no separate vote for the Developer by the subject Councilmember. Moreover, the unanimous vote indicates that any effect of a conflict would have been immaterial.

All documents pertaining to this meeting – agenda provided prior to the meeting and adopted minutes of the meeting-- are public records and can be accessed through the City's website. Accordingly, reference to any approval of the program occurring in "closed-session" should be removed.

Comment 13

The second paragraph of this section indicated that the Councilmember did not sign the disclosure statement until 15 months after approval of the list of developers. The list of developers was approved on June 1, 2009, and no participation in the NSP program occurred by Developer at issue until it won a bid to act as a contractor on property #5. As part of the review of documentation related to the award of contract to Developer for property #5, the Office of the City Attorney became aware of the potential appearance of a conflict of interest of Councilmember as president of the Developer. Based on standard practice under state law when such potential conflicts arise, the issue of confirming no financial interest was thoroughly documented. Though an exception was not requested, it is the opinion of the Office of the City Attorney that 1) no financial interest existed, and 2) that under state law no conflict of interest existed.

The Disposition and Development Agreement for said Developer was not executed until September 8, 2010 and the Developer was issued a notice to proceed on September 15, 2010. It was at this time the potential for a conflict of interest was identified, addressed by determining none existed because there was no financial interest, and each property file associated with the Developer was documented as such to address such potential concerns. Therefore, in response to the Report's statement that the disclosure was signed later in the process when the Developer became active, as no financial interest was identified by the Councilmember at the time of the vote for the program, no issue was identified to require recusal, request for an exception, or disqualification of the Developer from the program. Accordingly, we request that the statement in the final report be modified.

Comment 14

As for the conclusion in the last sentence of the second paragraph, that somehow "as a result, the councilmember's affiliation with the developer allowed it to inappropriately gain insider information regarding the program," **there is absolutely no evidence that *any* inside information was obtained**, and not even a documented argument put forth in the Draft Report to support this conclusion, Simply saying there was inside information does not make it so. All information provided regarding the program was presented to the public, and was available to the public through various channels, both at the time of decision and at the time of award of various contracts through the program. Ironically, it was not until the 5th property that the Developer at issue was awarded a contract under the program.

Comment 15

B. The City Claimed that HUD Was Aware of the Conflict of Interest

Grantee Response

Grantee maintains that at the time of the program HUD personnel were apprised of the affiliation between the Developer and the councilmember. Presumably, had the HUD representative been apprised of the issue, the representative would have advised that an exemption would need to be obtained. That advice did not occur. Therefore, an issue exists between a HUD representative (who had the Grantee advised of the

relationship did not follow HUD protocol by advising of the exception process) and the Grantee representatives who caused the issue to be well documented as a non-financial interest in its own files. The Grantee maintains that the representative was aware of the issue. In the future, such communication will be better documented to ensure memories over who was advised of such issues and what advice was provided --- or rather, not provided—at the time of such awareness.

C. The Developer May Have Received Preferential Treatment (Page 12)

Comment 16

(1.) The Affiliated Developer Was Given Preferential Agreement Terms (Page 12)

Grantee Response

The City treats all developers, contractors, and projects impartially. The sub-heading "The Affiliated Developer Was Given Preferential **Agreement Terms**" (emphasis added), is grossly inaccurate. The "terms" of the agreements were identical. Accordingly, if the Report's finding is in regard to *treatment* (i.e., receiving reimbursement for vandalism) then the heading should be rephrased to focus on "*treatment*" under the terms of the agreements, rather than the incorrect statement made in the Report (made without any support or example) that the "*terms*" of the agreement were somehow preferential or even different. Accordingly, the subheading should be removed in its entirety.

Second, the example relating to reimbursement for vandalism indicated in the second paragraph under "Developer May Have Received Preferential Treatment" on page 12 of the Report is misplaced and inaccurate. The reason referenced developer of property #2 was held responsible for making up $2,400 in costs associated with vandalism was because it was the second time that the property had been vandalized. After the City paid for the replacement following the *first* vandalism, staff notified the developer that the property must be properly secured, and that subsequent loss due to vandalism would not be paid by the City. Unfortunately, vandalism on a vacant property frequently occurs, and it has happened to properties #1, 3, 4, and 9, in addition to properties #2 and #5 referenced in the Report. Records for these are documented in each property file. The City followed its practice in paying for the replacement after the first vandalism, **and has not treated any developer or contractor in a preferential way**. We request that the statements in the Report be omitted in the final report.

Comment 17

(2.) The Affiliated Developer Did Not Have Full-Time Staff

Grantee Response

True. There is nothing in this heading that makes a cogent argument that a HUD regulation or program requirement were ever violated by running an efficient, lean organization by volunteer administrative labor. Indeed, at one time the Developer *did* have full time staff, but due to a lack of need for such full-time employee given the level of activity the organization was involved in at the time, the decision was made to not maintain any paid staff.

This paragraph does not appear to support the heading. The paragraph is made of the following statements: there was no full time staff; councilmember described the

organization as a volunteer organization; statement by councilmember that the organization likely would not have participated had they known of the recent interpretation of receipt-gathering requirements; a misstatement of that statement through an interpretation by the Report-writer as that "it appeared that the developer" did not have capacity to participate; a statement that the City allowed the Developer to participate; and a statement that the level of source documentation was not sufficient (such issue being discussed more thoroughly in Finding 1; then a conclusion that somehow the ties between the councilmember and the developer caused all of this. There is nothing in the sentences preceding the conclusion that support that outcome. This paragraph is comprised of a series of statements--- including a conjectural statement by the councilmember made in frustration over the level of detail being required four years after the fact—strung together to justify a conclusion that $36,026 in NSP funds were improperly provided to Developer. As such, there is no logical support for this conclusion. **More importantly, there is no requirement that there be full-time staff, and no relation between an all-volunteer staff and the proffered conclusion.** Therefore, it is requested that this paragraph be omitted from the Final Report. As for Recommendation 2A, no support exists for linking any developer's fees paid inappropriately and any potential violation of a conflict of interest, particularly since substantial evidence has been preserved and identified to demonstrate that no financial interest ever existed. As for Recommendation 2B, it goes without saying that Grantee will institute practices in the future to guard against second-guessing and heightened application of HUD regulations regarding both potential conflicts of interest, and non-financial potential conflicts of interest. In regard to Recommendation 2C for civil and administrative action against developer and councilmember, a review of administrative law and case law on point does not substantiate such recommendation. The case law upholding civil penalties against persons in a position such as councilmember does not support the fact pattern at issue here where a councilmember had no financial interest. Indeed, such sanctions are reserved for those occurrences where action financial interest occurs such as payment to family members for contracts approved by a governing board, has been concealed by active fraud such as name changes among family members, and where no documentation of no financial interest existed. In short, a prima facie case cannot be made for such a conflict, and a case warranting such sanctions is not present here.

Comment 18

Comment 19

As for the recommendation for civil penalties against the developer would only serve to harm the very community which HUD is tasked to protect: as a non-profit corporation per Developer's the corporate charter funds must be used for economic development purposes within this community; forfeiture of such monies in the possession of the corporation would merely prevent such amounts from being spent on development of affordable housing or other similar beneficial use within this community. While Grantee does not dispute that such remedy is effective against for-profit developers, or against non-profit developers with top-heavy administrative staff, here such remedy would only serve to be a disincentive for developer to continue in its work and ultimately harm the community it serves.

Comment 20

The City requests that any derogatory statements or assumptions in the draft Report which are not supported by facts be omitted in the final report. The City also requests that only statements directly applicable to actual meritorious violations of HUD regulations be included in the final report.

In conclusion, the City would like to thank Ms. Kelly Vance, Mr. Daniels Salinas, and Mr. Fredrick W. Lee for the technical assistance provided to the City during the Audit and the follow-up. If you have additional questions or need more information, please contact Ms. Benita DeFrank, Housing Manager, at (909) 620-2094 or Ms. Beverly Johnson, Grants Administrator, at (909) 620-2433.

Sincerely,

Mark L for

Linda Lowry
City Manager

Attachment

Cc: Mr. William Vasquez, Director, HUD Community Planning and Development
Mr. Robert Ilumin, Deputy Director, HUD Community Planning and Development
Mr. Wayne Itoga, Program Manager, HUD Community Planning and Development
Ms. Cielo Castro, NSP Specialist, HUD Community Planning and Development

OIG Evaluation of Auditee Comments

Comment 1 We disagree. The report did not question whether the developers can be a developer and general contractor. Our review questioned the issue of developers receiving developers' fees as well as profit and overhead. While it may be common practice in regular business practices for developers to earn a developers' fee and profit and overhead for services rendered, HUD's NSP prohibits such compensation. According to NSP Policy Alert: Guidance on Allocating Real Estate Development Costs in the Neighborhood Stabilization Program, Originally Released January 14, 2011, Updated September 16, 2011, the purpose of allowing the developer's fee to be included in the cost of a project is to compensate the developer for related overhead expenses and to provide a return on the developer's investment (appendix C).

The City referenced NSP Policy Alert referenced by the City, NSP Policy Alerts – "Guidance on Developers, Subrecipients, and Contractors" dated August 27, 2010 and update on November 16, 2011, that stated "a developer may charge contractor fee or brokerage fee if performing separate services for activity delivery and general administration." However, the two developers received payments from developers' fee and profit and overhead, not delivery and general administration as stated by the City. For instance, one of the two developers stated "overhead and profit (15%)" on its invoices related to services rendered at the properties. The second developer's accounting records showed overhead and profit for the unused portion of the approved project cost. As such, any practice in which the developer billed and received compensation for profit and overhead outside of developers' fees would be ineligible under the NSP Policy Alerts.

Comment 2 We disagree. We determined $2,008 in ineligible rehabilitation expenses based on the following:

a. $1,000 – The developer submitted and received payment for an invoice submitted in the amount of $5,750. This invoice detailed a description of work that was similar to the contract and invoice submitted by the third party vendor for $4,750. This resulted in the developer adding a $1,000 markup that would cover overhead and profit. However, this markup would have been covered by the developers' fee that the developer received for work performed under NSP. As a result, we believe that the developer's $1,000 markup is an ineligible expense.

b. $875 – The City used the percentage of completion method to reimburse developers and contractors. It did not require the developers and contractors to support rehabilitation costs before reimbursing them. As a result, the City could not have known that a duplicate payment was made to the developer. Source documentation was requested from the developer to support the reimbursement costs it received. By its own admission, the developer

indicated that $875 was a duplicate record. As a result, the $875 in duplicate asbestos survey costs was ineligible.

c. $100 – The City reimbursed rehabilitation expenses based on budgeted and not actual costs. As a result, the City did not review for actual expenses. We requested and reviewed the receipts and invoices provided by the developers and contractors to support its rehabilitation expenses. Based on our review, we determined that the City did reimburse the developer for those ineligible miscellaneous items using NSP funds.

d. $33 – The City reimbursed rehabilitation expenses based on budgeted and not actual costs. We requested and reviewed the receipts and invoices provided by the developers and contractors to support its rehabilitation expenses for the subject property. Based on our review, we determined that the City did reimburse the developer for the ineligible $33 in additional garbage disposal expenses.

Comment 3 We agree. We request that the City provide documentation to support the City's assertion that developers' fees were based on those eligible expenses mentioned in Comment 1 and 2. Based on this support, we will adjust the questioned developers' fees accordingly.

Comment 4 We disagree. The Federal Funding Accountability and Transparency Act (FFATA) executed on September 26, 2006, was used to reduce wasteful spending in the government. Since the City received $4.7 million in NSP funding, it is subject to the FFATA reporting requirements to reduce wasteful spending in the government. Further, 75 FR 64322 Section O. Reporting states that HUD will use grantee reports to monitor for anomalies or performance problems that suggest fraud, waste, and abuse of program funds. By reimbursing developers and contractors based on budgeted line item expenses deters from the FFATA requirement. Further, HUD cannot appropriately monitor the City for anomalies such as fraud, waste, and abuse without the City reporting actual costs of NSP rehabilitation projects. It should be noted that there were NSP grantees that maintained supporting documentation of program expenses in accordance with HUD rules and requirements.

The objective of this audit was to determine whether the City monitored its subrecipients and ensured that NSP expenditures were adequately supported and eligible. Cost reasonableness was not the objective of our audit. We appreciate the City taking the steps to work with the developers and contractors to obtain the required source documentation to meet HUD requirements. Based on the documentation, we will adjust the questioned costs as warranted during the audit resolution process.

Comment 5 We disagree. The copper pipe was used as an example as to how the City's use of percentage of completion was not the proper method of reimbursement since it

did not provide an accurate method of determining whether expenses were supported and eligible. Further, the City's source documentation, such as third party receipts and invoices only showed $185 in actual expenses for copper and not $5,000 as budgeted and reimbursed to the developer. As a result, we cannot remove this paragraph from the final report.

Comment 6 We disagree. The report did not indicate that the $8,565 was billed twice. The report states that the "developer submitted for reimbursement an invoice of $8,565 stating that work was completed and approved based on the City's inspection." However, the reviewed file included the general contractor's invoice for $8,565 that showed the description of work completed was different from what was on the developer's invoice. We believe that this instance supports the reasoning that source documentation, such as receipts for materials and labor, are necessary to determine whether the developer purchased items or performed rehabilitation work, as well as whether the City reimbursed these costs according to the scope of work. As a result, we cannot remove this statement from the report.

Comment 7 We appreciate the City's effort in working with the developers and contractor to 1) obtain legible receipts for $3,857 and 2) obtain $3,242 supporting documentation for project soft costs. Based on the documentation provided during the audit resolution phase, we will adjust these costs as warranted.

Comment 8 We agree. If the City can provide documentation to support the unsupported costs identified in this report, we will consider adjusting related unsupported developers' fees during the audit resolution process.

Comment 9 We disagree. The City had not been following HUD rules and requirements as well as its own internal agreements, policies, and procedures. As a result, the City was unable to support the eligibility of $584,148 in program expenses. We cited the criteria (appendix C) for specific HUD requirements, as well as its internal agreements, policies and procedures that the City did not follow. We do appreciate the City seeking clarification about the type of source documentation needed to meet HUD rules and requirements, specifically 24 CFR 570.506. The terms "invoices" and "receipts" are both types of source documents that would provide support of how the funds were used and whether such expenses were eligible. We appreciate that the City will take the necessary action to ensure compliance with HUD rules and requirements regarding record keeping of program expenses.

Comment 10 We disagree. Contrary to 24 CFR 570.611 and its internal agreements (appendix C), the City violated the conflict of interest requirement when it allowed the City's councilmember's affiliated developer entity to participate in the City's NSP. The criteria and internal agreements did not limit the conflict of interest to just financial interest. It should be noted that the councilmember in question did not provide OIG requested documentation to allow us to determine if there were

financial benefits earned under the arrangement. In addition, the councilmember's role as active president, as well as hands-on dealings on behalf of the developer would show benefits during the individual's tenure.

Comment 11 We disagree. The City was aware that the councilmember was affiliated with the developer; however, the City still allowed the councilmember to contribute in the decision-making in the board meetings and permitted its affiliated developer to participate in the NSP program. Although the City's councilmember signed a disclosure that no financial interest existed, we found that the councilmember was responsible for the bank account and signed all of the checks on behalf of the developer. Further, the City did not submit a written request to grant an exception, as required by 24 CFR 570.611(d), before the councilmember became involved with the developer's NSP activities. As a result, we cannot remove finding two from the report.

Comment 12 We disagree. HUD requirements and the City's internal agreements regarding conflict of interest did not limit the conflict of interest to only financial benefits (see appendix C). The councilmember's active involvement in the developer's participation in NSP-funded projects without written HUD approval violated HUD rules and requirements, as well as its own executed agreements between the developer and the City.

We removed the term "closed-session" board meeting to only state board meeting. The report does not mention that there was a separate vote for the developer with ties to the councilmember. Instead, the report referenced the fact that the councilmember did not recuse herself from the meetings when it approved the list of developers to participate in the NSP.

Comment 13 We disagree. Although a disclosure was signed, the conflict of interest was not disclosed until 15 months after approval of the list of developers. Since NSP funds are federal funds, not state funds, the City must follow federal (HUD) rules. Further, the City also contradicted its own internal agreement which states in "Section 902, Conflict of Interest (1) No member, official or employee of the City shall have any personal interest, direct or indirect, in this Agreement, nor shall any member, official or employee participate in any decision making to the Agreement which affects its personal interest or the interests of any cooperation, partnership or association in which it is directly or indirectly interested (see appendix C)." Based on HUD rules, as well as the executed agreement between the City and the developer, the councilmember should not have been involved with the developer.

Comment 14 We disagree. Because the subject councilmember serves on the City council, the individual was able to gain insider information regarding the program. In addition, the City mentioned that the developer used the councilmember's real estate experience and that the councilmember had many properties in Pomona, further helping the developer in the targeted area. As a result, the

councilmember's involvement with the City discussion about the NSP, as well as real estate experience provided the information that other developers would not have while participating in the City's NSP.

Comment 15 We disagree. We contacted the former HUD representative and he confirmed that the City did not mention the councilmember's involvement with the developer. Since no written documentation existed, we could not determine whether such disclosure to HUD existed. We agree that the City should ensure that any discussions or requests for waivers by HUD are documented in writing to ensure compliance, as well as minimize any issues such as conflicts-of-interest.

Comment 16 We disagree. We are stating that the affiliated developer connected to the councilmember was not held accountable for the costs of vandalism as opposed to the nonaffiliated developer who was held to the terms of the agreement and was responsible for making up the cost differences associated with the vandalism of NSP-funded properties. Paragraph 10 of the agreement for rehabilitation held the contractors liable for any costs to maintain or secure the properties (see appendix C). During the review, we did not find documentation that supported the City's claim of no preferential treatment given to the affiliated developer. During the exit conference, we stated that if the City would provide documentation to show that no such preferential treatment existed, we would consider revising the report statement in question. However, the City did not provide documentation for consideration in revising the report content. As a result, we could not determine if the City treated all developers in the same manner and must keep the content within the report.

Comment 17 Based on further review, we removed this paragraph from the report. However, it is still our position that the councilmember's involvement with the affiliated developer violated conflict-of-interest rules stated in the executed agreement with the City as well as HUD rules and requirements.

Comment 18 We disagree with the following:

Recommendation 2A – The City and councilmember violated HUD requirements and its internal agreements which do not limit conflict of interest to only financial interest. As mentioned in the previous comments, the councilmember's active involvement with the developer without written HUD approval before the start of NSP violated HUD rules and requirements, as well as those agreements executed between the developer and the City (see appendix C). As a result, we believe that the recommendation is appropriate.

Recommendation 2B – We commend the City for its plans on implementing recommendation 2B to ensure compliance and minimize any future issues of conflicts-of-interest.

Comment 19 Based on our recommendation and the documentation obtained during the review, we will defer to HUD's Associated General Counsel to determine whether appropriate civil and administrative actions should be taken against the councilmember, City, and the developer for the conflicts-of-interest issue identified in this report.

Comment 20 We removed the term "closed-session" and "inappropriately" from the report. However, we believe that the issues of incurred ineligible and unsupported, as well as the conflict-of-interest involving the councilmember and affiliated developer are factually supported based on the results of the review.

Appendix C

CRITERIA

2 CFR Part 225 (Office of Management and Budget Circular 87), Appendix A to Part 225

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

j. Be adequately documented.

24 CFR 570.506

Each recipient shall establish and maintain sufficient records to enable the Secretary to determine whether the recipient has met the requirements of this part. At a minimum, the following records are needed:

(h) Financial records, in accordance with applicable requirements listed in section 570.502, including source documentation for entities not subject to parts 84 and 85 of this title. Grantees shall maintain evidence to support how the CDBG funds provided to such entities are expended. Such documentation must include, to the extent applicable, invoices, schedules containing comparisons of budgeted amounts and actual expenditures, construction progress schedules signed by appropriate parties (e.g. general contractor and/or a project architect), and/or other documentation appropriate to the nature of the activity.

Office of Management and Budget Circular-133

CFDA 14.256 [Catalog of Federal Domestic Assistance] Neighborhood Stabilization Program (Recovery Act Funded)

I. Program Objectives

The objectives of the Neighborhood Stabilization Program (NSP) are to (1) stabilize property values; (2) arrest neighborhood decline; (3) assist in preventing neighborhood blight; and (4) stabilize communities across America hardest hit by residential foreclosures and abandonment. These objectives will be achieved through the purchase and redevelopment of foreclosed and abandoned homes and residential properties that will allow those properties to turn into useful, safe and sanitary housing.

HERA, Paragraph 2301(d)(3), Sale of Homes

If an abandoned or foreclosed upon home or residential property is purchased, redeveloped, or otherwise sold to an individual as a primary residence, then such sale shall be in an amount equal to or less than the cost to acquire and redevelop or rehabilitate such home or property up to a decent, safe, and habitable condition.

Federal Register 75 FR 64322

H. Eligibility and Allowable Costs

Requirement

1. Use of grant funds must constitute an eligible use under HERA.

2. In addition to being an eligible NSP use of funds, each activity funded under NSP must also be CDBG-eligible under 42 U.S.C. 5305(a) and meet a CDBG national objective.

O. Reporting

Background

HUD will use grantee reports to monitor for anomalies or performance that suggest fraud, waste, and abuse of funds; to reconcile budgets, obligations, fund draws, and expenditures; to calculate applicable administrative and public service limitations and the overall percent of benefit to LMMI persons; and as a basis for risk analysis in determining a monitoring plan.

NSP Policy Alert: Guidance on Allocating Real Estate Development Costs in the Neighborhood Stabilization Program, Originally Released January 13, 2011, Updated September 16, 2011

Developer's Fees

The purpose of allowing the developer's fee to be included in the cost of a project is to compensate the developer for related overhead expenses and to provide a return on the developer's investment (which return may be referred to as "profit" for simplicity's sake). The overhead expense intended to be defrayed by the developer's fee is very similar to the General Administrative costs in the grantee budget, and may include such indirect costs as rent, utilities, and other expenses that cannot be linked to a specific project.

NSP Policy Alert: Guidance on Developers, Subrecipients, and Contractors – Updated November 16, 2011

Regarding activity delivery and general administration, developer may charge contractor fee or brokerage fee if performing these separate services.

Agreement for Rehabilitation

10. … In addition, CONTRACTOR shall secure the PROPERTY to ensure that squatters and the public are unable to enter the PROPERTY or obtain access to the back yard or other non-public areas of the site. CONTRACTOR shall be solely responsible for all costs incurred to maintain and secure the PROPERTY. In no event shall the CITY be liable for any such costs, nor shall CITY be liable for any such costs, nor shall CITY be required to reimburse CONTRACTOR for any such costs incurred to maintain or secure the PROPERTY during the course of the rehabilitation.

Disposition and Development Agreement

Section 102, Definitions

(11) Final Rehabilitation Report. Final Rehabilitation Report means a report to be submitted by Developer to City upon completion of the rehabilitation of Property, which shall include detailed information regarding the actual, final Rehabilitation Costs incurred with respect to the Property, the actual Scope of Development performed at the Property, actual profit and overhead paid to contractors and subcontractors, and all approved change orders.

Section 902, Conflict of Interest

(1) No member, official or employee of the City shall have any personal interest, direct or indirect, in this Agreement, nor shall any member, official or employee participate in any decision relating to the Agreement which affects its personal interests or the interests of any corporation, partnership or association in which it is directly or indirectly interested.

Section 1500, Records, Reports, and Audits

(1) Developer shall maintain, at reasonable times and places, make available to the City such records and accounts, including property, personnel, and financial records that the City and/or state and federal agencies deem necessary to ensure proper accounting for all NSP funds.

(5) Developer shall maintain all books, records, plans, and data relating to this Agreement for (20) years.

24 CFR 85.40, Monitoring and reporting program performance

(a) Monitoring by grantees. Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

City of Pomona Community Development Department Monitoring Plan

B. Financial Monitoring - All project costs are paid on a reimbursement basis, rather than paid in advance. A request for reimbursement must have appropriate documentation attached to verify all expenditures.

24 CFR 570.611

(b) *Conflicts prohibited.* The general rule is that no persons described in paragraph (c) of this section who exercise or have exercised any functions or responsibilities with respect to CDBG activities assisted under this part, or who are in a position to participate in a decision making process or gain inside information with regard to such activities, may obtain a financial interest or benefit from a CDBG-assisted activity, or have a financial interest in any contract, subcontract, or agreement with respect to a CDBG-assisted activity, or with respect to the proceeds of the CDBG-assisted activity, either for themselves or those with whom they have business or immediate family ties, during their tenure or for one year thereafter. For the UDAG program, the above restrictions shall apply to all activities that are a part of the UDAG project, and shall cover any such financial interest or benefit during, or at any time after, such person's tenure.

(c) *Persons covered.* The conflict of interest provisions of paragraph (b) of this section apply to any person who is an employee, agent, consultant, officer, or elected official or appointed official of the recipient, or of any designated public agencies, or of subrecipients that are receiving funds under this part.

(d) *Exceptions.* Upon the written request of the recipient, HUD may grant an exception to the provisions of paragraph (b) of this section on a case-by-case basis when it has satisfactorily met the threshold requirements of (d)(1) of this section, taking into account cumulative effects of paragraph (d)(2) of this section.

Federal Funding Accountability and Transparency Act (FFATA) was signed on September 26, 2006. The intent is to empower every American with the ability to hold the government accounting for each spending decision. The end result is to reduce wasteful spending in the government.

Appendix D

TABLE OF QUESTIONED COSTS BY PROPERTY

Finding 1 - ineligible expenses

Property	Ineligible profit and overhead	Ineligible prorated developer fee	Ineligible rehabilitation expenses	Total ineligible expenses
1	$21,388	$1,497	-	$22,885
3	-	-	$875	$875
4	$15,385	$1,851	$40	$17,276
5	-	-	$14	$14
6	-	-	$1,072	$1,072
7	-	-	$7	$7
Total	**$36,773**	**$3,348**	**$2,008**	**$42,129**

Finding 1 - unsupported expenses

Property	Unsupported costs	Unsupported prorated developer fee	Total unsupported expenses
2	$78,933	$2,636	$81,569
3	$3,500	-	$3,500
4	$63,353	$7,602	$70,955
5	$94,037	-	$94,037
6	$59,105[8]	-	$59,105
7	$22,580	-	$22,580
8	$118,424	-	$118,424
9	$133,978	-	$133,978
Total	**$573,910**	**$10,238**	**$584,148**

Finding 2 – ineligible expenses

Property	Ineligible
5	$7,050
6	$13,389
7	$15,587
Total	**$36,026**

[8] We were unable to determine the latter half of a receipt for the amount totaled $55,863.19 of the $59,105. As a result, this unsupported amount may be more. Of the $59,105 in unsupported costs, $3,242 was for the unsupported total development costs incurred during the resale of the property.