



City of New York

OFFICE OF THE COMPTROLLER

Scott M. Stringer
COMPTROLLER



AUDITS AND SPECIAL REPORTS

Marjorie Landa

Deputy Comptroller for Audit

Audit Report on the Department of
Housing Preservation and Development
Engineering Audit Office's Compliance
with Comptroller's Directive No. 7

SE15-119A

April 26, 2017

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

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To the Residents of the City of New York:

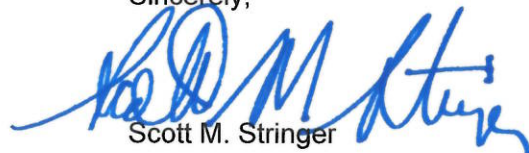
My office has audited the New York City Department of Housing Preservation and Development (HPD) to determine whether HPD's Engineering Audit Office (EAO) is complying with the provisions of Comptroller's Directive #7, *Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services*. Directive #7 provides City agencies' engineering audit officers with directions on how they should conduct independent audits of payment requests for construction, equipment and related consultant service contracts, prior to those payments being processed in the City's Financial Management System and to require that such audits be conducted. We audit agency engineering audit offices as a means of ensuring that contractors and vendors have fulfilled their contractual obligations to the City.

The audit found that HPD's EAO did not always follow appropriate audit procedures to ensure compliance with Directive #7. We found deficiencies in the EAO's operations and also in HPD's procedures that undermined the EAO's function. In particular, we found 154 payment requests totaling \$2.3 million were not submitted to the EAO for the required review and approval before HPD paid the contractors. In addition, we were unable to ascertain whether \$9.6 million in payments to contractors for sampled demolition projects were justified. Those payments consist of \$8.7 million in contract charges that HPD paid without documentation of a complete and adequate EAO review and nearly \$900,000 in contract charges that HPD paid without any EAO review and approval at all. The observed deficiencies reflect weaknesses in HPD's internal controls, which include: inadequate written policies and procedures for the EAO's work; fiscal procedures that fail to ensure that all required payment requests are reviewed and approved by the EAO; an impermissible EAO reporting structure; and the absence of performance metrics to track and assess the EAO's performance, and the absence of any such metrics or system to ensure that HPD management is alerted to systemic contract-management weaknesses uncovered by the EAO's reviews of payment requests.

The audit makes 19 recommendations, including that HPD should develop complete and consistent EAO recordkeeping and reviews in accordance with Directive #7; ensure that the EAO conducts field visits to physically verify requested payment amounts and adequately documents the results of the field visits in accordance with Directive #7; ensure that the EAO's prevailing wage compliance procedures include all tests required by Directive #7; and ensure that the EAO maintains complete review records, including desk audit reports, field audit reports and other substantiating documentation.

The results of the audit have been discussed with HPD officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report. If you have any questions concerning this report, please e-mail my Audit Bureau at audit@comptroller.nyc.gov.

Sincerely,



Scott M. Stringer

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER AUDITS AND SPECIAL REPORTS

Audit Report on the Department of Housing Preservation and Development Engineering Audit Office's Compliance with Comptroller's Directive No. 7

SE15-119A

EXECUTIVE SUMMARY

The New York City Department of Housing Preservation and Development (HPD) is the largest municipal housing preservation and development agency in the nation. Its mission is to promote the construction and preservation of affordable, high quality housing for low- and moderate-income families in thriving and diverse neighborhoods in every borough by enforcing housing quality standards, financing affordable housing development and preservation, and ensuring sound management of the City's affordable housing stock. Various HPD divisions further the agency's mission by, among other things, contracting with private companies to manage capital construction projects, demolish unsafe structures, and make building repairs. These activities are intended to resolve housing maintenance complaints, to maintain physical stability of existing affordable housing, and to preserve and create quality affordable housing.

Under the authority set forth in the New York City Charter, the New York City Comptroller has issued Comptroller's Directive #7, *Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services*. This Directive requires that certain City agencies establish Engineering Audit Offices to conduct independent audits of payment requests for construction, equipment and related consultant service contracts, prior to those payments being processed in the City's Financial Management System (FMS).¹ The Directive further provides directions on how such audits should be conducted.

Pursuant to Directive #7, HPD's Engineering Audit Division (EAO) is supposed to, among other things, conduct reviews to ascertain the accuracy of payment amounts charged by contractors and vendors, including prices, quantities and calculations; perform field visits to physically verify work progress; and determine whether invoiced work has been completed in accordance with plans and specifications, and that the City has received appropriate value.² Based on the results

¹ An Engineering Audit Office must be headed by an Engineering Audit Officer who is either a New York State licensed Professional Engineer or Registered Architect, staffed by a designated alternate Engineering Audit Officer and personnel with appropriate construction and/or audit experience.

² Throughout this report, the abbreviation "EAO," which stands for Engineering Audit Office, is used to refer to the HPD's Engineering Audit Division to be consistent with the language in Directive #7. HPD's Engineering Audit Division is headed by a Director who is referred to as the Director of the EAO.

of Directive #7 reviews, the EAO may request clarification and additional documentation, and approve, revise, or reject payment requests.

According to records maintained by HPD's EAO, a total of 9,268 payment requisitions totaling \$56.1 million, including payment requests for change orders, were audited by the EAO during Fiscal Years 2014 and 2015.

Audit Findings and Conclusions

The audit found that HPD's EAO did not implement or follow appropriate procedures to ensure the EAO's and HPD's full compliance with Directive #7. Specifically, we found that not all of the EAO's payment request reviews were conducted in accordance with the requirements of Directive #7. Further, we found deficiencies in HPD's operations that undermined the EAO's function. In particular, we found that not all payment requests subject to Directive #7 were submitted to the EAO for the required reviews and approval before HPD paid the contractors.

As a result of those deficiencies in HPD's procedures and in the operation of the EAO, we were unable to ascertain whether \$9.6 million in sampled payments to contractors for demolition projects were justified. Those sampled payments consist of \$8.7 million in contract charges that HPD paid without documentation of a complete and adequate EAO review and nearly \$900,000 in contract charges that HPD paid without any EAO review and approval at all. Accordingly, while it is possible that the invoiced demolition work we sampled was completed, HPD's files did not contain adequate documentation to verify that the amounts paid were appropriate. In particular, even among the sampled payments that the EAO approved, most lacked evidence that the EAO performed required field audits and that its desk audits were adequate to justify the amounts paid.

Further, we found that in addition to the nearly \$900,000 in 7 payment requests we identified in our sample as having been paid without submission to the EAO for review or approval, HPD failed to submit an additional 154 payment requests for demolition work to the EAO and, as a result, HPD paid an additional \$2.3 million to contractors without any assurance by the EAO that the prices, quantities and calculations reported on the payment requests were accurate, that the contractors fulfilled their contractual obligations, and that the City received appropriate value for the payments requested.

In addition, we found discrepancies among the records maintained by HPD related to processing and payments for construction, demolition and repair work. Overall, HPD's records reflected that the agency processed 20,838 *more* payment requests for construction, demolition and repairs projects than were provided to the EAO for review.

All of the deficiencies we observed in our audit reflect weaknesses in HPD's internal controls, which include: inadequate written policies and procedures for the EAO's work; inconsistent records that ostensibly reflect the same transactions; fiscal procedures that fail to ensure that all payments subject to Directive #7 are reviewed and approved by the EAO; an impermissible reporting structure that compromises the EAO's authority to serve as an independent check on HPD's construction payments; and the absence of performance metrics or any equivalent system for agency management to track and assess the EAO's performance, and the absence of any such metrics or system to ensure that HPD management is alerted to systemic contract-management weaknesses uncovered by the EAO's reviews of payment requests.

Audit Recommendations

This report makes a total of 19 recommendations, including that HPD:

- Develop complete written EAO review policies and procedures that assure complete and consistent EAO recordkeeping and reviews in accordance with Directive #7;
- Ensure that the EAO conducts field visits to physically verify requested payment amounts and adequately documents the results of the field visits in accordance with Directive #7;
- Ensure that the EAO's prevailing wage compliance procedures include all tests required by Directive #7, including but not limited to comparison of contractors' daily sign-in sheets with other records specified in the directive, or alternatively, if the EAO relies on HPD's Labor Monitoring Unit to obtain relevant information, that the Labor Monitoring Unit conducts all of the tests required by Directive #7;
- Ensure that the EAO maintains complete review records, including desk audit reports, field audit reports and other substantiating documentation;
- Ensure that payments are processed in accordance with the PPB's prompt payment provisions;
- Develop and distribute written policies and procedures that clearly set forth processes across the agency to ensure compliance with Directive #7 and that reinforce the EAO's role and authority;
- Ensure that all required payment requests are submitted to and reviewed by the EAO prior to any payments being made;
- Establish performance metrics for the operation of the EAO;
- Systematically track reasons for reductions and rejections, and monitor issues raised by the EAO that would help the agency improve its internal control environment as well as the EAO's oversight function;
- Enforce HPD's Standard Construction Contract Article 41 by requiring demolition and other contractors to submit bid breakdowns within 15 days of HPD directing them to proceed with contract work;
- Ensure that the EAO reports directly to the agency head or a deputy agency head as mandated by Directive #7. Establish an organizational structure that provides adequate authority to the EAO, supports the independence and integrity of the audit process, and provides a mechanism for improving internal controls; and
- Designate an alternate Engineering Audit Officer.

Agency Response

In its response, HPD disagreed with the vast majority of the findings and recommendations and stated that "[t]he audit report is flawed. HPD's demolition jobs are mostly emergency situations not specifically addressed in Directive No. 7. . . . HPD's Engineering Audit Office (EAO) is in compliance with Comptroller's Directive No. 7 (Directive), which explicitly allows the EAO to utilize professional judgement in the development and execution of audit procedures depending on the nature of the work or project, the type of payment requested, and the state of work completion. .

. . . HPD's EAO has developed a thorough and rigorous program of effective and efficient audit operations for HPD's demolition and emergency repair work, which meets the goals of the Directive."

This response from HPD evidences a fundamental misconstruction of both the meaning and intent of Directive #7, which is designed to ensure that the City receives appropriate value for construction, equipment and construction-related service contracts. The Directive's express expectation that EAOs will exercise professional judgment does not justify a departure from the specific controls set forth in the Directive absent a proper basis and the existence of compensating controls that ensure the furtherance of Directive #7's goals. As is expressly stated in Directive #7, the EAO is expected to "exercise professional judgment, *consistent with the intent of these guidelines*, to determine the nature and extent of the audit procedures necessary for evaluating the payment requests under review." (Emphasis added.) In response to the audit, HPD failed to provide evidence of the EAO's having engaged in such determinations or of how the intent of Directive #7 would be furthered by the alternative procedures that were being followed. Accordingly, we do not accept HPD's claim that the agency's and the EAO's failures to comply with Directive #7's requirements were acceptable exercises of professional judgment. While it is unquestioned that Directive #7 allows the EAO Director to use his professional judgment to determine the nature and extent of audit procedures, that flexibility cannot be used as an excuse for the pervasive undocumented disregard of procedures established by Directive #7.

HPD also stated in its response that "[i]n our view, the Audit Report is flawed because the auditors . . . rejected valid evidence from HPD showing that desk audits and field visits were conducted, [and] ignored evidence that photographs were stored electronically by job address, and failed to acknowledge that HPD's LMU [Labor Monitoring Unit] handles all of the agency's prevailing wage matters." However, as is discussed in detail below, the auditors carefully considered all of the evidence tendered by HPD of the reviews conducted, photos taken and the reviews conducted by the LMU. In accordance with Generally Accepted Government Auditing Standards, we credited HPD fully for every piece of reliable information the agency provided.

INTRODUCTION

Background

HPD is the largest municipal housing preservation and development agency in the nation. Its mission is to promote the construction and preservation of affordable, high quality housing for low- and moderate-income families in thriving and diverse neighborhoods in every borough by enforcing housing quality standards, financing affordable housing development and preservation and ensuring sound management of the City's affordable housing stock.

HPD divisions further the agency's mission by, among other things, contracting with private companies to manage capital construction projects, demolish unsafe structures, and make building repairs.³ These activities are intended to resolve housing maintenance complaints, to maintain physical stability of existing affordable housing, and to preserve and create quality affordable housing. Before HPD pays the private contractors, many of the HPD divisions that engage in these activities submit payment requests associated with the projects to the HPD's EAO, which is supposed to review and approve every payment request for construction and construction-related services prior to payment.

Under the authority set forth in the New York City Charter, the New York City Comptroller has issued Comptroller's Directive #7, *Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services*, to provide City agencies' engineering audit officers with directions on how they should conduct independent audits of payment requests for construction, equipment and related consultant service contracts prior to those payments being processed in FMS and to require that such audits be conducted.⁴ Directive #7 requires that all payment requests—regardless of amount—must be reviewed by the EAO to ensure that the contractor has fulfilled its contractual obligations, and that the City has received appropriate value, under the terms of the contract, for the payment requested.

Among other things, pursuant to Directive #7, the EAO is supposed to conduct reviews to ascertain the accuracy of payment amounts including prices, quantities and calculations; perform field visits to physically verify work progress; and determine whether invoiced work has been completed in accordance with plans and specifications and the City has received appropriate value. To that end, field and desk audits are supposed to be conducted to help ensure that work has been performed to warrant the requested payment and that contractors have complied with applicable contract provisions pertaining to permits, specifications, and prevailing wages. Directive #7 further requires that when payments are authorized based solely on a desk audit, the EAO's records must clearly record the reasons that the field audit was not conducted, and field audit procedures must be performed subsequently to ensure that the payment made based on the desk audit was proper.

³ HPD's construction work originates in a number of ways. Demolition projects are initiated at the Department of Buildings as a result of emergency violations issued on the properties or by court order. These projects include full/partial brace and shore, sealing a building, netting a building, sidewalk sheds, etc. The work scope includes privately-owned buildings, abandoned structures, and demolition due to collapses and fire. Capital construction projects are initiated at various HPD units for a variety of purposes. These projects cover work such as lead abatement, major plumbing and electrical work, and restoration work at private and City-owned buildings. Smaller repair jobs, known as Open Market Orders, are mostly initiated at the HPD's Division of Maintenance. These small repairs projects include boiler repair, carpentry, plumbing, window repairs, and mildew removal, at private and/or at City-owned buildings.

⁴ Directive #7, §3.4.1 specifies that "construction" includes "demolishing...any building, facility or physical structure of any kind." Accordingly, demolition contracts and all payments and changes thereunder must be audited by the EAO as required by Directive #7.

Based on the results of Directive #7 reviews, the EAO may request clarification and additional documentation, and approve, revise, or reject payment requests. The EAO is also responsible for determining the validity and cost reasonableness of change order requests and for conducting comparisons and analyses of those requests with contract requirements and allowable project scopes. Additionally, before authorizing any payments for change order work, the EAO is required to ensure that the change orders have been registered with the Comptroller's Office.

In connection with this audit, HPD officials informed us that the agency maintains relevant records of contractors' payment requests for construction and related services on its information system, HPDInfo, supplemented by hard copy files. The officials further informed us that the HPD EAO keeps details of payments reviewed on Excel spreadsheets and audit records are maintained in hard copy files. According to the HPD EAO's records, a total of 9,268 payment requisitions totaling \$56.1 million, including payment requests for change orders, were audited by the EAO during Fiscal Years 2014 and 2015.

Objective

The objective of this audit is to determine whether HPD's Engineering Audit Division is complying with the provisions of Comptroller's Directive #7.

Scope and Methodology Statement

We conducted this performance 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter. This audit was conducted by auditors with engineering backgrounds. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

The scope of this audit covers payment requests for construction, demolition, and repair service projects that were approved for payment by the HPD's EAO in Fiscal Years 2014 and 2015.

Discussion of Audit Results

The matters covered in this report were discussed with HPD officials during and at the conclusion of this audit. A preliminary draft report was sent to HPD on December 22, 2016, and discussed at an exit conference on January 10, 2017. After the exit conference, HPD provided auditors additional supporting documentation regarding some of the findings discussed in the preliminary report, all of which was carefully reviewed. Where appropriate, the findings were revised to reflect the additional information. On February 17, 2017, we submitted a draft report to HPD officials with a request for comments. We received a written response from HPD on March 6, 2017.

In its response, HPD disagreed with the vast majority of findings and recommendations and stated that "[t]he audit report is flawed. HPD's demolition jobs are mostly emergency situations not specifically addressed in Directive No. 7. . . . HPD's Engineering Audit Office (EAO) is in compliance with Comptroller's Directive No. 7 (Directive), which explicitly allows the EAO to utilize professional judgement in the development and execution of audit procedures depending on the

nature of the work or project, the type of payment requested, and the state of work completion. . . . HPD's EAO has developed a thorough and rigorous program of effective and efficient audit operations for HPD's demolition and emergency repair work, which meets the goals of the Directive." HPD asserted that, among other things, "[t]he auditors rejected valid evidence from HPD showing that desk audits and field visits were conducted." Additionally, HPD stated that "[a]ll payments approved by the EAO were justified, followed Procurement Policy Board (PPB) rules, and there were no overpayments." HPD claimed that the EAO "maintains evidence of field inspections, time stamped photographs, and observations of the demolition site in either hard copy or electronic form."

However, in attempting to rebut the audit findings, HPD did not provide any affirmative evidence that contradicted the audit's findings. Instead, it contends that its deviations from the specific requirements of Directive #7 were permissible exercises of professional judgment by the EAO. In making this claim, however, HPD failed to provide any documentation reflecting that, in fact, the specific circumstances warranted deviation from Directive #7's requirements, and how the intent of Directive #7's requirement would be furthered with the alternative procedures that were followed. Thus, we do not accept HPD's claim that the EAO's failures to comply with Directive #7's requirements were acceptable exercises of professional judgment. We agree with HPD that Directive #7 allows the EAO to use his professional judgement to determine the nature and extent of the audit procedures. However, as HPD notes, Directive #7 expects the EAO to "exercise professional judgment, *consistent with the intent of these guidelines*, to determine the nature and extent of the audit procedures necessary for evaluating the payment requests under review." (Emphasis added.) Thus, the EAO must follow procedures set forth in Directive #7, and accordingly, when his professional judgement requires him to deviate from these procedures, the EAO must document the reasons for such deviation and the procedures established to ensure that invoiced work has been completed in accordance with plans and specifications and the City has received appropriate value.

HPD's claim that its repeated failures to adhere to the requirements of Directive #7 were merely permissible exercises of professional judgment by the EAO were undercut by the agency's changing and inconsistent positions on what its own conduct and policies were. In particular, HPD variously claimed that the EAO was conducting field audits for demolition work and then that the EAO was *not* conducting such field visits because they were not required. However, whatever the official position of the agency, contrary to its assertions in the audit response, we did not find any "time stamped photographs" in any of the HPD files we were provided that evidenced field inspections by the EAO. Further, we found that the files also lacked field inspection reports documenting the EAO's observations for all of the 18 sampled payment requests we reviewed.

With regard to all but two of the audit recommendations, HPD claimed that "the recommendations are either not appropriately tailored to HPD's operations, have already been implemented, or are not within the scope of Directive No. 7." This response reflects, however, a fundamental failure by HPD to recognize its responsibilities under Directive #7. As described in more detail in the report below, the audit found that HPD's recordkeeping is inadequate, not all payment requests are being submitted to the EAO prior to the payment to contractors, and in cases where payment requests were submitted and audited by the EAO, the reviews were not consistently made in accordance with the requirements of Directive #7. Further, the agency's lax internal controls, specifically its lack of tracking and follow-up on the issues raised by the EAO and inadequate policies and procedures, have had a direct impact on agency's internal controls. As a result, we found that there is an increased risk of fraud, waste and abuse in connection with HPD's payments governed by Directive #7.

Consistent with our findings and recommendations, HPD has corrected the EAO's reporting structure and the EAO now reports to the agency's First Deputy Commissioner. This change, mandated by Directive #7, will help provide the EAO the authority to serve as an independent check on HPD's construction payments. In addition, HPD has appointed an alternate EAO. Both changes will hopefully strengthen the operations and effectiveness of HPD's EAO. We continue to urge the agency to adopt the rest of the recommendations in this audit report.

The full text of HPD's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

The audit found that HPD's EAO did not implement or follow appropriate procedures to ensure the EAO's and HPD's full compliance with Directive #7. Specifically, we found that not all of the EAO's payment request reviews were conducted in accordance with the requirements of Directive #7. Further, we found deficiencies in HPD's operations that undermined the EAO's function. In particular, we found that not all payment requests subject to Directive #7 were submitted to the EAO for the required review and approval before HPD paid the contractors.

As a result of those deficiencies in HPD's procedures and in the operation of the EAO, we were unable to ascertain whether \$9.6 million in payments to contractors for sampled demolition projects were justified. Those payments consist of \$8.7 million in contract charges that HPD paid without documentation of a complete and adequate EAO review and nearly \$900,000 in contract charges that HPD paid without any EAO review and approval at all. Accordingly, while it is possible that the invoiced demolition work was completed, HPD's files did not contain adequate documentation to verify that the amounts paid were appropriate. In particular, even among the sampled payments that the EAO approved, most lacked evidence that the EAO performed required field audits and that its desk audits were adequate to justify the amounts paid.

Further, we found that, in addition to the nearly \$900,000 in 7 payment requests we identified in our sample as having been paid without submission to the EAO for review or approval, HPD failed to submit an additional 154 payment requests for demolition work to the EAO and, as a result, HPD paid an additional \$2.3 million to contractors without any assurance by the EAO that the prices, quantities and calculations reported on the payment requests were accurate, that the contractors fulfilled their contractual obligations, and that the City received appropriate value for the payments requested.

In addition, we found discrepancies among the records maintained by HPD related to processing and payments for construction, demolition and repair work. Overall, HPD's records reflected that the agency processed 20,838 *more* payment requests for construction, demolition and repairs projects than were provided to the EAO for review.

All of the deficiencies we observed in our audit reflect weaknesses in HPD's internal controls, which include: inadequate written policies and procedures for the EAO's work; inconsistent records that ostensibly reflect the same transactions; fiscal procedures that fail to ensure that all payments subject to Directive #7 are reviewed and approved by the EAO; an impermissible reporting structure that compromises the EAO's authority to serve as an independent check on HPD's construction payments; and the absence of performance metrics or any equivalent system for agency management to track and assess the EAO's performance and to be alerted to contract-management issues uncovered by the EAO's reviews of payment requests.

HPD Response: HPD stated that it disagreed with the vast majority of findings and recommendations and that "[t]he audit report is flawed. HPD's demolition jobs are mostly emergency situations not specifically addressed in Directive No. 7. . . ." HPD stated that auditors failed to appreciate how stand-alone demolition work differs from typical multi-phased construction projects. HPD contended that Directive #7 allows for discretion in the implementation of requirements related to the types of emergency work that were the subject of this audit and allows the EAO Director to use his professional judgement in the use of audit procedures depending on the nature of work.

HPD asserted that “[t]he auditors rejected valid evidence from HPD showing that desk audits and field visits were conducted” Additionally, HPD stated that “[a]ll payments approved by the EAO were justified, followed Procurement Policy Board (PPB) rules, and there were no overpayments.” HPD claimed that the EAO “maintains evidence of field inspections, time stamped photographs, and observations of the demolition site in either hard copy or electronic form.”

Auditor Comment: HPD’s response lacked evidence that directly contradicts the audit findings. According to Directive #7, the EAO’s professional judgement must be made in accordance with the intent of the guidelines set forth in the Directive. It follows that when circumstances and the EAO Director’s professional judgement require him to deviate from Directive #7’s procedures, the EAO must adequately document those procedures, including the reasons for such deviation and how the substitute procedures will ensure that invoiced work has been completed in accordance with plans and specifications and that the City has received appropriate value.

Moreover, while Directive #7 allows the policies and procedures governing EAO reviews to be adjusted in accordance with the professional judgment of the EAO, it does not allow deviation from the requirements governing *what* payments are covered by Directive #7. Accordingly, *all* payment requests remain subject to Directive #7 and, absent an express waiver from the Office of the Comptroller, they must be submitted to the EAO for the review and approval before HPD pays the contractor. Further, HPD has failed to recognize that Directive #7, §3.4.1 specifies that “construction” includes “demolishing . . . any building, facility or physical structure of any kind.” Finally, contrary to HPD’s claim in its audit response, we did not find any “time stamped photographs” in any of the HPD’s files evidencing field inspections by the EAO, and the files were also lacking field inspection reports documenting the EAO’s observations for all 18 sampled payment requests.

These matters are discussed in greater detail in the following sections of this report.

Questionable Payments

We found that HPD approved \$9.6 million in sampled payments for demolition work either without the required EAO review or without maintaining required documentation to support the EAO’s approval. New York City Comptroller’s Directive #7, *Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services*, provides agencies’ engineering audit officers with directions for conducting independent audits of payment requests for construction, equipment and related consultant service contracts, prior to those payments being processed in FMS.⁵ In addition, according to Directive #7, §5.2, “After completion of the audit, the EAO must retain all notes, documents, reports and recommendations. The documentation must be sufficiently thorough to support the audit findings, payment certifications, disputed payments or any other action taken.”

We reviewed a sample of 36 payment requests for demolition work totaling \$10.2 million that HPD approved during Fiscal Years 2014 and 2015. Our review included all of the documentation that HPD made available to us regarding the 36 payment requests, which the agency informed us included all of the records in its possession that reflected the EAO’s reviews. Our sample included

⁵ Directive #7, §3.4.1 specifies that “construction” includes “demolishing...any building, facility or physical structure of any kind.”

32 payment requests totaling \$9,612,682 for contracted demolition work and 4 payment requests totaling \$624,807 for associated change orders.

Payments are considered questionable where there is insufficient evidence that the payment requests were appropriately audited by the EAO in accordance with Comptroller's Directive #7. Our findings are described below.

Nonexistent and Inadequate EAO Review of Contract Payments

HPD's records for 7 of the 32 sampled payment requests for contracted demolition work, totaling \$894,280, contained no evidence of review and approval by the EAO prior to HPD's processing the payments in FMS. For the remaining 25 payment requests (32 minus 7) totaling \$8,718,402, which the EAO did review and approve, we identified the following deficiencies:

- The records for 18 payment requests lacked evidence of required field audits by the EAO;
- The records for 15 payment requests lacked evidence that desk audits conducted by the EAO included all required elements, specifically, reviews by the EAO of calculations, prices, and quantities supporting the payment requests;
- The records for 22 payment requests lacked daily sign-in sheets necessary to comply with prevailing wage requirements; and
- 8 payments did not comply with the New York City Procurement Policy Board Rules (PPB) prompt payment provisions.⁶

(See Appendix I for a list of the 32 sampled payments and problems associated with each.)

Overall, we found that the EAO did not maintain adequate documentation of that office's review of payment requests related to the demolition work we sampled. To the extent there was documentation of the EAO's reviews, most of it was maintained in the Demolition Division files and not in the EAO's files, which is contrary to the express requirements of Directive #7. Moreover, apart from the issue of *where* the records were maintained, in the majority of cases, HPD's records did not establish that the EAO performed all audit procedures required by Directive #7. We note that the preparation and maintenance of adequate documentation of the EAO's review is not only necessary to ensure the integrity of HPD's payment process, but, as stated in Directive #7, §5.2, is "essential for dispute resolution, claim investigation, and litigation purposes." Outside the scope of this audit, we found that two of the five contractors who performed work on our sampled projects had filed claims against the City for payment disputes. Gaps in the documentation of the EAO's reviews could compromise the City's ability to investigate and defend against such claims.

Lack of Evidence of Field Visits

The EAO did not maintain adequate evidence to establish whether field visits required by Directive #7 were conducted. Directive #7, §3.2, states that "[a]n essential EAO audit procedure is the performance of field visits to physically verify the requested payment amounts and to evaluate the quality and progress of the work in question." Of the 25 sampled demolition payments that the EAO reviewed and approved, field visits were required for 18, totaling \$8,704,826. However, the files for all 18 approved payments lacked evidence that field visits had been made. Evidence,

⁶ The Procurement Policy Board Rules, Section 4-06, requires payments to be made within 30 days. The allowable limit in the case of substantial completion payments or final payments on construction contracts and in case of change orders is 60 days.

such as inspection reports, dates of visits, comments, and photos with pertinent information, which would have indicated that the EAO conducted the required field visits to evaluate the progress of the work as necessary to verify the requested payment amounts, was not in the files.

For example, we reviewed the files for a \$1,269,360 payment request for Breeze National, a contractor hired to demolish Tower #3, a 15-story building at 1776 Prospect Place in Brooklyn (project #DB00213). The work scope also included removal of other structural items and free standing items on-site, securing the site after completion of the demolition work, and replacing the damaged sidewalk. Directive #7 requires that before authorizing payment for such work, the EAO auditors physically inspect the work to verify that the contractor had completed it, which in this case, should have included inspections to determine the following facts: whether all specified structural items, such as pavements, curbs, stairways, and free standing items such as bollards, signs, posts, light poles, play equipment, were removed; whether specified trees were removed; whether damaged sidewalk was replaced with four-inch thick concrete as required by code; whether the site was graded as required by the HPD inspector; and whether the site was secured. However, the files for this payment request contained no evidence of such inspections.

In another example, the EAO approved a \$1,136,889 payment request for A. Russo Wrecking for the demolition of P.S. 31, a seven-story brick building at 425 Grand Concourse in the Bronx (project #DE00544). In this case, EAO auditors should have inspected the work site to verify that all required permits had been obtained, site protections were installed, and that the claimed demolition of a roof and the fifth floor at the front of the building was completed to justify the requested payment. Again no evidence was found in the files that such inspections were ever made.

In both these examples, field inspections should have been performed to verify the completed and in-progress work and enable the EAO auditors to determine that the requested payment amounts were justified. In addition, desk audits should have also been performed in both cases to ensure that payment amounts were supported by appropriate documentation and that the calculations were correct. However, there was no evidence in the files for either of the two payment requests that the EAO had conducted the required field inspections, and in both cases the records of the desk audits that were performed lacked evidence that the EAO had reviewed the calculations, prices, and quantities supporting the requested payment amounts.

Further, the above cited \$1,269,360 payment request was for substantial completion and/or final payment. Directive #7, §3.6, requires that, “[u]pon substantial completion of a project, as defined in the contract, the EAO must perform a comprehensive review of payments and conduct a field visit to verify that all work has been satisfactorily and substantially completed under the terms of the contract, or that incomplete work, including all punch list items...has been identified, evaluated based on a cost-to-complete basis, and certified by the resident engineer.” In this case, we found no evidence that any of those requirements were met.

In a third example, a payment request by A. Russo Wrecking for \$142,110, also for the demolition of P.S. 31 in the Bronx was reduced by \$112,000 by the EAO (project #DE00544). Although evidence of a desk audit was present in the files, we found no evidence that a required field visit was conducted and no explanation for why it was not conducted. Directive #7, §3.2.2 (c), requires that a field inspection must be performed whenever a desk audit or other information discloses discrepancies or other problems. Additionally, Directive #7, §3.3, requires that, “[w]hen payments are authorized based solely on a desk audit, the EAO’s records must clearly record the reasons that the field audit was not conducted. When desk audits are conducted, field audit procedures must be performed subsequently to ensure that the payment based on the desk audit was proper.”

Overall, the HPD files for the 18 payment requests that should have been verified by EAO field visits did not contain evidence of such field visits or the EAO's reasons for not conducting them. In the absence of such file documentation, we asked HPD officials for *any* documents they had that would substantiate that the EAO had, in fact, conducted field visits in connection with those 18 payment requests. In response, the HPD officials, including the EAO Director, initially stated that in their opinion, EAO field inspections were not necessary to verify payments for demolition work, as opposed to other kinds of construction work. Nevertheless, notwithstanding that stated opinion, the HPD officials subsequently provided several documents, such as photos, several of which were undated and unmarked, ostensibly of project sites, and copies of EAO auditors' route sheets, with an email and annotations indicating that they constituted evidence that EAO auditors *had* conducted field visits to the demolition sites in our sample. However, because the documents HPD submitted lacked pertinent details such as project numbers, site information and, most importantly, the EAO auditors' observations, we found that they did not reliably demonstrate that EAO auditors physically verified requested payment amounts and evaluated the quality and progress of the work, as required by Directive #7, §3.2 – *Field Audits*.

During and after the exit conference HPD provided additional documentation, including: (1) several photos HPD had not previously provided, with no indication of their source or of which, if any, specific payments they concerned; (2) three additional route sheets of EAO auditors, which HPD representatives said were from HPD's "Administration files"; and (3) five EAO checklists with checkmarks purportedly showing that certain documents were reviewed in connection with five of the 18 sampled payment requests that lacked evidence of EAO field visits, but with no indication of who prepared them, when they were prepared, whether they purported to be evidence of field visits made by EAO auditors, or why they were not provided to us in response to multiple previous requests for all relevant records. In sum, none of the newly-provided material described above reliably demonstrated that EAO auditors, prior to approving payments, conducted field visits for the purpose of physically verifying the basis for the requested payment amounts and evaluating the quality and progress of the work.

Failure to Test for Labor Law Compliance

The HPD EAO failed to test for compliance with New York State's prevailing wage law in accordance with Directive #7, §3.8, which mandates that the EAO conduct tests "to ensure contractor compliance with prevailing wage requirements" and requires "[v]erification that the contractor is compliant with New York State Labor Law, Article 8, §220, paragraph 3-a.a." The EAO is specifically required to conduct sufficient audit tests of: (i) periodic certified payrolls showing all individual trade employees; (ii) daily sign-in sheets signed by each worker showing time in and out; and (iii) actual wages and benefits paid and/or provided to employees.⁷ To guide the EAO, a copy of Labor Law § 220 is included in Directive #7 as Attachment A.

According to HPD officials, the HPD EAO does not directly conduct the tests for compliance with the Labor Law, but rather relies on HPD's Labor Monitoring Unit to obtain relevant information. However, the EAO's reliance on the Labor Monitoring Unit does not relieve it of its obligation to obtain all of the information required by Directive #7. Moreover, we found no evidence that certain required tests were conducted by the EAO, HPD's Labor Monitoring Unit, or by anyone at HPD. Among other things, we found no evidence that sign-in sheets were reviewed before HPD officials approved payments for 28 of the 32 payment requests for contract demolition work in our sample.⁸

⁷ Directive #7, §3.8 further requires that the EAO conduct audit tests of an additional set of records known as "construction management labor inventories from the daily construction diaries." Those records were inapplicable to the contracts in our sample.

⁸ The 28 payment requests include 22 of the 25 payment requests reviewed by the EAO plus 6 of the 7 that were not reviewed by the EAO.

The hardcopy files that HPD provided, which were maintained by the Demolition Division and not by the EAO, included none of the records specified in Directive #7 as necessary to review pursuant to Directive #7, §3.8, except for certified payroll reports. Evidence of the tests required by Directive #7 should be in the EAO's files, or at very least in the possession of the agency. HPD provided no explanation for the absence of the contractors' daily sign-in sheets and other evidence of testing for prevailing wage compliance.⁹

Directive #7 requires the EAO to perform tests for compliance with the prevailing wage law and, in the event that the EAO finds that the audited records are inconsistent, the EAO must withhold from payment sufficient funds to cover the difference as well as 16 percent per annum simple interest. Based on the available documentation, we could not determine whether such withholding by the EAO may have been warranted. Moreover, we found no evidence that all required testing for prevailing wage compliance was ever done by HPD.

Recommendations

HPD should:

1. Develop complete written EAO review policies and procedures that assure complete and consistent EAO recordkeeping and reviews in accordance with Directive #7.

HPD Response: "HPD is in compliance with Directive No. 7 requirements to have adequate policies and procedures related to record keeping and reviews. Procedures and checklists provided to auditors were developed based on the EAO's professional judgment and are appropriate for review of invoices."

Auditor Comment: Notwithstanding the agency's claim that it "is in compliance with Directive No. 7 requirements to have adequate policies and procedures related to record keeping and reviews," we found the EAO's policies and procedures to be incomplete and inadequate to meet HPD's operational needs. As detailed below under the heading *Inadequate Policies and Procedures*, the EAO lacked procedures that addressed many of Directive #7's requirements necessary for ensuring the effective and efficient EAO operation, supporting the independence and integrity of the audit process, and providing a mechanism for improving internal controls.

2. Ensure that the EAO's policies and procedures include frequency and timing of field visits to physically verify requested payment amounts.

HPD Response: "HPD is in compliance with Directive No. 7 requirements for adequate policies and procedures related to record keeping and reviews. Written procedures and checklists for field visits were developed based on the EAO's professional judgment and were provided to auditors."

Auditor Comment: As previously stated, we found the EAO's policies and procedures to be incomplete and inadequate. The EAO's written procedures for field audits lacked specific guidance for conducting field inspections and did not adequately set forth the frequency of required inspections, the types of documentation

⁹ Prior to the exit conference, HPD's assertion was that 14 payment requests related to two projects, #DB00213 and #DB00214, were not subject to prevailing wage requirements; the agency later acknowledged that the prevailing wage requirements applied to those payment requests.

that must be maintained, and parameters for determining when a field audit is not feasible.

3. Ensure that the EAO conducts field visits to physically verify requested payment amounts and adequately documents the results of the field visits in accordance with Directive #7.

HPD Response: “HPD is in compliance with Directive No. 7 requirements. EAO inspectors completed field visits following existing procedures for the 18 sampled payments and documentary evidence was provided to auditors. The existing procedures and documentation were developed based on the EAO’s judgment, and are consistent with Directive No. 7.”

Auditor Comment: To support its claim of adequate documentation of invoices related to field visits, HPD points to entries on the EAO auditors’ route sheets that reflect occasional visits to project sites, and photos purported to be evidence of EAO field visits. We determined that seven of the 16 route sheets submitted by HPD were likely related to the sampled payment requests based on the dates of visits which coincided with the EAO review period. The remaining nine route sheets, whose dates did not coincide with the EAO’s payment requests review period, were deemed unrelated to specific payment requests. Additionally, none of the photos submitted by HPD from the project files (rather than the EAO’s files) were identified as being taken by EAO auditors in connection with specific payment requests and did not consistently contain notations that reflected the dates they were taken, the locations, or the project numbers. While twelve photos submitted by HPD contained dates and building numbers associated with two projects (#s DB00213 and DB00214), we could not determine which payment requests they were related to and did not find any notations that reflected observations made by the EAO auditors concerning how, if at all, these photos supported any payment requests. Thus, the actual documentation that HPD provided did not support its claims related to the existence of the EAO’s field visits. The information HPD provided was not an adequate substitute for inspection reports prepared by the EAO auditors that documented observations and determinations, was supported by photographic evidence taken during the visits, and that included when and who prepared the reports. HPD failed to provide such evidence.

4. Ensure that the EAO records reasons why field audits were not conducted in the cases when payments were authorized based solely on desk audits.

HPD Response: “HPD is in compliance with Directive No. 7 requirements. EAO inspectors went on field visits for the 18 sampled payments as mentioned in *Agency Response 3*. Therefore, desk audits were not the sole basis for the payments approved by EAO.”

Auditor Comment: We did not find adequate evidence to corroborate HPD’s claim that EAO inspectors went on field visits for the 18 sampled payment requests. As noted in the audit and also reiterated in the auditor comments above (recommendation #3), HPD’s records lacked adequate evidence reliably demonstrating that EAO auditors, prior to approving payments, conducted field visits for the purpose of physically verifying the basis for the requested payment amounts and evaluating the quality and progress of the work.

5. Ensure that the EAO's prevailing wage compliance procedures include all tests required by Directive #7, including but not limited to comparing contractors' daily sign-in sheets with other records specified in the directive, or alternatively, if the EAO relies on HPD's Labor Monitoring Unit to obtain relevant information, that the Labor Monitoring Unit conducts all of the tests required by Directive #7.

HPD Response: "HPD is already in compliance with Directive No. 7. The assertion that HPD did not manage compliance with prevailing wage rules is false. HPD has a dedicated labor monitoring unit as described above and the EAO depends on the expertise of the professional labor monitoring staff. No payments for prevailing wage jobs are released without LMU's [the Labor Monitoring Unit's] approval."

Auditor Comment: Directive #7 expressly directs the EAO to conduct certain tests to ensure that payments are not made to contractors who have not complied with the Prevailing Wage Law. In this regard, as will all of the EAO's responsibilities under Directive #7, the EAO is intended to provide independent oversight of agency's functions. It is simply not sufficient to say, as HPD does here, that the EAO's oversight is unnecessary because another part of the agency already performs the role. Moreover, even if the LMU's reviews of prevailing wage compliance were deemed an acceptable substitute for the EAO's reviews through the Comptroller's waiver process, as noted in the audit report, we did not find any evidence that HPD's Labor Monitoring Unit (instead of the EAO) had conducted all tests required by Directive #7 and had provided relevant approvals to the EAO. Specifically, the records lacked evidence that tests had been conducted to verify that daily sign-in sheets were signed by each worker showing time in and out, and whether the contractors were in compliance with this requirement, in accordance with Directive #7, §3.8 (b) (ii).

6. Ensure that the EAO conducts independent reviews of prevailing wage requirements to confirm whether contractors are in compliance with all prevailing wage requirements or seek a waiver from the Comptroller's Bureau of Accountancy with respect to delegating responsibility of conducting tests for compliance with the prevailing wage requirements from the EAO to the agency's Labor Monitoring Unit.

HPD Response: "HPD has a dedicated labor monitoring unit and EAO depends on the expertise of the professional labor monitoring staff in HPD's Labor Monitoring Unit. No payments for prevailing wage jobs are released without LMU's approval."

Auditor Comment: Pursuant to Directive #7, the EAO is responsible and accountable for conducting *independent* reviews of prevailing wage requirements to confirm whether contractors are in compliance with all prevailing wage requirements. If the agency believes it can adequately comply with this Directive #7 requirement through LMU administering the prevailing wage compliance tests without compromising the required independence, in accordance with the Comptroller's policy established pursuant to Chapter 5, Section 93 of the New York City Charter, HPD must seek a waiver from the Comptroller's Office prior to relieving the EAO of this critical independent function.

7. Ensure that the EAO maintains complete review records including desk audit reports, field audit reports and other substantiating documentation.

HPD Response: “HPD already has thorough and rigorous policies and procedures related to record keeping and reviews. Per EAO's judgment the Agency's present documentation is consistent and in compliance with Directive No.7.”

Auditor Comment: As stated in the audit report, HPD's recordkeeping practices do not comply with the provisions of Directive #7. We found that the records for 18 sampled payment requests lacked adequate evidence of required field audits by the EAO. In addition, we found that the records for 15 payment requests lacked adequate evidence that desk audits conducted by the EAO included all required elements. Specifically, reviews by the EAO of calculations, prices, and quantities supporting the payment requests. Further, we found that the records for 22 payment requests lacked daily sign-in sheets necessary to comply with prevailing wage requirements. Each of these types of documentation are crucial for establishing that the EAO conducted required tests, that the amounts paid by HPD were justified, and the City received appropriate value.

8. Ensure that payments are processed in accordance with the PPB's prompt payment provisions.

HPD Response: “HPD is already in compliance with Directive No. 7 requirements. Documentation from the Financial Management System and HPDInfo was provided to the auditors, proving that these payments were not due interest in accordance with the PPB Rules. The Fiscal Unit ensures that Prompt Payment Rules are followed, as per the PPB rules. The payments are made within the 30-day allowable time period or 60 days for substantial completion of job or final payments on construction contracts, including time extensions allowed due to lack of required payroll submissions and EAO adjustments to reduce the invoice according to PPB Rules, Section 4-06.”

Auditor Comment: We carefully reviewed the additional documentation and explanations provided by HPD to justify the time extensions we found. We credited some of the information provided to us but we nonetheless determined that eight payments were still not made within the 30-day period prescribed in the PPB Rules in the case of a partial payment or 60-day period allowed for a substantial or final payment. The PPB Prompt Payment guidelines indicates that an extension of the required payment date is allowed to satisfy certain circumstance that prevent prompt payment, including issues raised by the EAO (payment reductions) to authorize a payment. Specifically, in three cases when invoiced amounts were reduced by the EAO (for project #s DE00544, DC00021, and DE000381), the payment dates were extended. However, in each case, the agency appeared to use as the start date for determining the timeliness of payments, the dates when the EAO prepared audit reports for the reductions rather than the dates when the EAO actually approved the payment requests. This had the effect of impermissibly giving the agency additional time to process the payments.

Untimely Change Order Review

We found that the EAO relied on the Demolition Division staff and on documents prepared or furnished by the New York City Housing Authority, the project contractor and a subcontractor to validate a \$613,041 sampled change order for asbestos abatement, air monitoring and disposal work (projects #s DB00213 and DB00214). According to the EAO audit report (dated 3/28/14) for

this change order, the work was completed prior to the EAO's being notified of the change order. (The audit revealed that HPD had already made several payments on these projects without the required EAO review and approval, an issue described previously in this report). Although the EAO ultimately reviewed and approved the payment requested by the contractor for the work specified in the change order, the change order request itself, which established the contractor's right to request that payment, was not previously submitted to the EAO for an independent determination of its validity and cost reasonableness. With no opportunity to review the validity and cost reasonableness of the change order proposal, the EAO's ability to independently audit the validity and reasonableness of the subsequent associated payment request was compromised.

Recommendation

HPD should:

9. Ensure that all change order requests are timely submitted to the EAO for an independent determination of their validity and cost reasonableness.

HPD Response: "The Agency's existing policy is for the EAO to pre-approve change orders before starting additional work."

Auditor Comment: Our audit found that HPD did not follow this policy. The EAO's audit report (dated 3/28/14) showed that additional asbestos abatement, air monitoring and disposal work (projects #s DB00213 and DB00214) totaling \$613,041 was not only started but was actually completed prior to the EAO's approval of the change order.

Payments Made without EAO Review and Approval Reflect Internal Control Weaknesses

As discussed above, through our review of a sample of demolition payment requests, we found no evidence that the EAO reviewed and approved seven demolition payment requests, totaling \$894,280, from our 32 sampled payment requests before HPD processed those payments in FMS.¹⁰ In addition, we found that, overall, HPD has made \$3,198,431 in payments to contractors for demolition work without the EAO's review and approval based on a comparison of all demolition payment requests listed in the HPDInfo system and/or Demolition Division records for Fiscal Years 2014 and 2015 with the EAO's records of all of the demolition payment requests it reviewed for those two years.¹¹ Specifically, we found that out of 1,182 payment requests that HPD paid to demolition contractors according to the HPDInfo system and/or Demolition Division records, 161 payment requests, including seven from our previously-discussed sample, were not reviewed and approved by the EAO. Consequently, HPD paid \$3,198,431 to contractors without any assurance by the EAO that the prices, quantities and calculations reported on the payment requests were accurate, that the contractors fulfilled their contractual obligations, and that the City received appropriate value for the payments requested. A summary of these findings is contained in Table I below.

¹⁰ The \$894,280 in our initial sample is included in the figure \$3,198,431.

¹¹ We used four fields (project #, address, amount requested and amount approved) to compare these two lists.

Table I**Demolition Payment Requests Analysis**

Payments	HPD list			EAO list		
	# of Payments	Amount Requested	Amount Approved	# of Payments	Amount Requested	Amount Approved
Present on both lists*	951	\$ 21,434,764	\$ 20,864,775	950	\$ 21,434,765	\$ 20,864,774
Questionable due to data entry errors**	57	\$ 3,384,868	\$ 3,155,189	57	\$ 3,410,503	\$ 3,139,784
Present on EAO list but not on HPD list				91	\$ 5,204,390	\$ 4,920,269
Present on HPD list but not on EAO list	173	\$ 3,403,166	\$ 3,338,474			
Evidence of EAO's review approval present	13	\$ 156,013	\$ 140,043			
No evidence of EAO's review and approval***	161	\$ 3,247,153	\$ 3,198,431			
Total	1182	\$ 28,222,798	\$ 27,358,438	1098	\$ 30,049,658	\$ 28,924,827

* Two payments totaling \$49,828 were represented as a one payment on the EAO list.

** When either project #, requested amount, and/or approved amount did not match.

*** Includes a payment of \$13,315 not on HPD or EAO list but found in HPD Demolition Division files; also includes 106 unreconciled payment requests and 54 payment requests for which HPD did not provide adequate supporting documentation.

Directive #7, §3 mandates that, “[t]he EAO's primary function is to audit contractor, vendor, and consultant payment requests prior to approval of FMS Accounting payment requests for construction, equipment, and construction related service contracts, in accordance with this Directive's audit guidelines.” However, we found that HPD does not have uniform policies and procedures to ensure that EAO is able to fully perform this function. We were informed by officials from various HPD divisions, including Maintenance, Demolition, and Fiscal, that each division had its own interpretation of when a payment request should be sent to the EAO for review. While HPD officials with responsibility for agency-wide administration stated that they believed that payment requests below \$600 and change orders below \$150 do not have to be submitted to the EAO for review and approval, that belief appears to reflect an unwritten policy that is not followed uniformly throughout HPD. Further, that policy is not supported by the plain language of Comptroller's Directive #7, and HPD never requested a waiver from the Comptroller's Office, Bureau of Accountancy, to omit payment requests for construction and construction-related work below \$600 and change orders below \$150 from the EAO review and approval.

Moreover, the existence of a policy excluding payment requests below \$600 from review by the EAO would not, if true, explain the number of payment requests that HPD did not submit to its EAO prior to payment. We found that only a small fraction – 8 of the 160 payments that were made without prior review and approval by the EAO (totaling \$2,591) – were for amounts below the reported \$600 threshold for EAO review. The remaining 152 payments made by HPD without prior review and approval of the EAO (totaling \$3,182,525) exceeded that amount.¹²

According to HPD's practice, when one of the HPD divisions responsible for construction, demolition or repair work subject to Directive #7 enters a payment request for such work into the HPDInfo system, that division is supposed to direct the request to the EAO, which should trigger

¹² Corresponding analysis for the change orders was not performed because we were unable to isolate demolition change orders from the change order lists, both on the HPDInfo system list and the EAO list.

an EAO review. The EAO's approval should be entered into the system before the HPD Fiscal Division pays the contractor. However, HPD does not have controls in place to ensure that all such payment requests are in fact directed to the EAO or to prevent HPD's Fiscal Division from paying the contractor without the EAO's approval.

Inadequate policies, procedures, and fiscal controls to ensure compliance with Directive #7 likely contributed to HPD's payment of several million dollars to contractors without the required levels of review and approval by the EAO.

HPD's Recordkeeping Problems

HPD records did not consistently and accurately account for construction-related payment requests subject to Directive #7 that were processed by the agency. We compared HPD's records of construction-related payments it made with the payment requests reviewed and approved by the EAO, and found \$2.3 million in demolition payment requests that were made without EAO review and approval. Further, in the course of our comparison of the records maintained by the agency in its HPDInfo system with those maintained by HPD's Demolition Division, and those maintained by the EAO, we found recordkeeping problems that both reflect and that might have contributed to HPD's failure to comply with the requirements of Directive #7. In addition, a payment for \$13,315 (project #DE00381) was only present in the Demolition Division's hard copy files, and was not recorded either in the HPDInfo system or on those maintained by the EAO.

(See Appendix II for a list of problems with HPD's recordkeeping.)

Inconsistent Records of Demolition Payment Requests

For the sampled 36 demolition payment requests, we examined hard copy documentation maintained by the Demolition Division and prepared a list of payment requests with associated approved amounts that we then compared with the EAO's spreadsheet summary of payment requests it had reviewed and approved, and then further compared these with the information contained in the HPDInfo system. Although these three sets of records purported to reflect the same transactions, we found a number of discrepancies among them. Primarily, we identified inaccuracies in the EAO's records, including incorrect amounts reported for individual payment requests that the EAO reviewed.

We also found transactions listed in one HPD record and not listed in other records that should have contained corresponding entries and documentation. Specifically, we found:

- A payment request for \$1,269,360 from Breeze National (project #DB00213) was recorded twice in the HPDInfo system, once for the full amount and again as two entries totaling the full amount (i.e., \$697,599 and \$571,761), each using the same payment requisition number (#8), which should be a unique number to identify a single payment request. In effect, HPDInfo double-counted the payment request, while the EAO's records did not.¹³
- In connection with a reported credit to HPD of \$41,280 from Breeze National (project #DB00213) the EAO's spreadsheets reflect two credits, each for \$20,640, totaling \$41,280; while the HPDInfo system contains only a single entry for a \$20,640 credit,

¹³ EAO's record reflected a payment request of \$5,717,611, which should have been recorded as \$571,761, apparently due to a data-entry error.

meaning that half the credit amount reflected in the EAO's record was missing from HPDInfo.

- An approved payment request for \$13,315 from RD2 Construction and Demolition (project #DE00381) was found in the HPD Demolition Division files but not in either the HPDInfo system or the EAO's records. The audit confirmed that the payment was made to the contractor.

As a result of the inconsistent information maintained, respectively, in the Demolition Division's files, by the EAO, and in the HPDInfo system, differing total dollar amounts approved are shown for the 36 sampled payment requests. After the exit conference, HPD provided explanations for a number of discrepancies noted in the preliminary draft report. Based on the updated comparison, the Demolition Division's records reflect that the total amount approved for the 36 payments including an adjustment for a credit to HPD, was \$10,196,209, while according to the EAO's spreadsheets, the approved total was \$7,832,955, and according to the HPDInfo system the total amount approved was \$11,514,173.¹⁴

Overall, we found that seven payment requests totaling \$894,280 were missing from the EAO's spreadsheets, one payment request totaling \$1,269,360 was double-counted in the HPDInfo system, and one credit of \$20,640 and one \$13,315 payment request were missing from that system.

Inconsistent Records of HPD's Total Construction Payment Requests

The problems in recordkeeping that we found in our sample of 36 demolition payment requests reflect problems agency-wide, and could be clearly seen in the results of our comparison of HPDInfo system records with the EAO's records contained in spreadsheets maintained by that office. In response to our request for all of HPD's payments for construction work during the audit period, HPD provided us with records from HPDInfo that were organized in the following four categories: demolition, capital, open market orders (repairs), and change orders. According to those HPDInfo records, HPD processed 30,106 payment requests related to demolition, construction and repair work during Fiscal Years 2014 and 2015. However, the EAO spreadsheets of payment requests reflect that the EAO reviewed only 9,268 such payment requests, 20,838 fewer than the payment requests identified as per HPDInfo system ($30,106 - 9,268 = 20,838$). The total dollar amount of the payment requests reflected in HPDInfo records was \$56,956,779, while the total dollar amount of payment requests listed in the EAO's records was \$56,199,371. Accordingly, the data contained in HPDInfo reflects that 20,838 more construction-related payment requests were processed by HPD during the audit period than the EAO reviewed. The data in HPDInfo also reflects that the total amount paid by HPD related to these payment requests was \$757,408 more than the totals reflected in the EAO's records ($\$56,956,779 - \$56,199,371 = \$757,408$).¹⁵ As illustrated in Table II, there were no instances in

¹⁴ Prior to the exit conference, the Demolition Division's records reflected that the total amount approved for the 36 payments was \$10,237,489, while according to the EAO's spreadsheets, the approved total was \$13,985,505, and according to the HPDInfo system the total amount approved was \$9,856,082. Also, a change order reflecting \$41,280 in credit due to HPD was not present in the Demolition Division's records.

¹⁵ By contrast, prior to the exit conference, the total reflected as per the HPD's records was \$5,388,442 less than the totals reflected in the EAO's records. At the exit conference, according to HPD, \$5,388,442 discrepancy was due to two erroneous entries resulting in an adjustment of \$6,145,850 in the total amount approved in the EAO's records. This adjustment is reflected in the revised \$757,408 discrepancy amount.

which the number of payment requests and the dollar amounts reflected in the HPDInfo system matched those reflected in the EAO's records.

HPD provided explanations for the above-described inconsistencies between different sets of HPD records at the exit conference. According to HPD, all 20,838 payment requests that were recorded in HPDInfo and not in the EAO's records reflect payments of up to \$600 that did not require EAO review under HPD's previously-described unwritten policy. However, HPD did not identify any specific payment requests or provide details to support that explanation. With respect to the discrepancy between the EAO's and HPDInfo's respective listings of total dollar amount of construction-payment requests submitted to the agency, HPD attributed the difference to two data entry errors in the EAO's records. No further explanation was provided by HPD.

Table II

Variations in Payment Requests Records

Work Type	HPD records (1)		EAO records (2)		Variation in EAO records (2) - (1)	
	# of Payment Requests	Amount Requested	# of Payment Requests	Amount Requested	# of Payment Requests	Amount Requested
Demolition	1,181	\$ 28,209,483	1,098	\$ 30,049,658	↓ (83)	↑ 1,840,175
Capital	41	\$ 4,149,673	88	\$ 2,804,359	↑ 47	↓ (1,345,315)
Open Market Orders	28,540	\$ 22,990,129	7,868	\$ 20,026,781	↓ (20,672)	↓ (2,963,347)
Change Orders	344	\$ 1,607,494	214	\$ 3,318,573	↓ (130)	↑ 1,711,079
TOTAL	30,106	\$ 56,956,779	9,268	\$ 56,199,371	↓ (20,838)	↓ (757,408)

Comptroller's Directive #1, *Principles of Internal Control*, Section 5.0 specifically cites Accurate and Timely Recording of transactions as an example of an internal control and states that transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and decision making. In addition, according to Directive #7, Section 5.1,

EAO audits and EAO compliance with this Directive are dependent on the availability of agency and contractor records. Agencies must ensure that the records referenced herein and all other appropriate documentation, are maintained and made available to the EAO for audit purposes.

The existence of inconsistent records in different divisions of HPD, all ostensibly reflecting the same transactions, suggests that HPD's system of internal control should be reviewed and improved to ensure that it is comprehensive, has adequate controls and is provided to all relevant personnel.

Recommendations

HPD should:

10. Develop and distribute written policies and procedures that clearly set forth processes across the agency to ensure compliance with Directive #7 and that reinforce the EAO's role and authority.

HPD Response: "HPD already has thorough and rigorous policies and procedures related to record keeping and reviews."

Auditor Comment: Despite the agency's claim that it has "thorough and rigorous policies and procedures" related to its record keeping, we determined that HPD lacked policies in many areas, and in cases where it has policies and procedures "related to recordkeeping and reviews," they were either incomplete or were not always followed. For example:

- HPD lacked policies and procedure that ensure all required payment requests are submitted to the EAO for review and approval prior to payment to contractors, and that records are adequately maintained throughout the agency to facilitate reconciliation between various HPD divisions and to ensure accountability. Consequently, based on our review of HPD's internally inconsistent records, we found that 161 demolition payment requests totaling over \$3 million may not have been forwarded to the EAO review and approval. In such cases, these requests would have been paid without the required EAO reviews and approvals to ensure that the City received appropriate value for the payments requested. In addition, HPD still has not been able to reconcile the Fiscal Years 2014 and 2015 payment records—slightly over 30,000 records, totaling over \$50 million, a significant amount—and explain the discrepancy between the HPDInfo and the EAO records. Absent such a reconciliation, there is no way to determine exactly how many and which payment requests were in fact reviewed by the EAO or should have been reviewed by the EAO, prior to payments that were made to contractors.
- HPD lacked complete written EAO review policies that assure complete EAO recordkeeping and reviews in accordance with Directive #7.
 - EAO's procedures were incomplete. They lacked procedures for: conducting field inspections, with adequate details setting forth the frequency of inspections, the types of documentation necessary, and parameters for determining when a field audit is not feasible; substantial completion payment request reviews; and the process to be followed to evaluate prevailing wage compliance.
 - EAO did not maintain complete review records, including desk audit reports, field audit reports and evidence of prevailing wage compliance.
- HPD records lacked bid breakdowns for 18 of the 32 sampled payment requests.

As recommended in our audit, the EAO now reports directly to first Deputy Commissioner and an alternate EAO has been appointed. These are positive changes. We urge HPD to carefully review the findings and follow the other recommendations we have made in this audit report.

11. Ensure that all required payment requests are submitted to and reviewed by the EAO prior to any payments being made.

HPD Response: “HPD exercises its judgment in compliance with Directive No. 7 requirements for policies and procedures relating to which payment requests are submitted to and reviewed by the EAO prior to payment. The Agency policy is for the HPD EAO to review payments of \$600 and above. The threshold is based on the EAO's analyses of the type and dollar amount of the payments, and was introduced years ago to ensure the most efficient use of public resources. Invoices under \$600 are mostly no access fees and small repairs, and in fiscal year 2014-5, represented 72% of the payments. HPD's policy enables the EAO to focus on auditing the invoices for work over \$600, which represented 93% of the value of total payment amounts in the audit time period.”

Auditor Comment: Directive #7 requires HPD to submit *all* payment requests to the EAO for review and approval. Only after a payment request is submitted for review and approval is the EAO expected to exercise professional judgement to determine the nature and extent of the audit procedures necessary for evaluating specific type of payment request submitted. Directive #7 does not allow HPD to process payments without the EAO's approval, nor does it allow the EAO to fail to review entire categories of payments altogether. Accordingly, HPD's unilateral policy to refrain from reviewing payment requests of \$600 or less and change orders of \$150 or less is in direct violation of Directive #7. HPD failed to provide auditors with any written procedures and analyses to support this policy or with a waiver from the Comptroller's Bureau of Accountancy permitting HPD to deviate from the requirements of Directive #7. As a result of its unwritten and unauthorized policy, over 20,000 payment requests under \$600 totaling over \$4 million and nearly 90 change order payment requests under \$150 totaling over \$1 million made by HPD may have been paid *without* the required EAO reviews during Fiscal Years 2014 and 2015. Further, as stated in the audit report, we identified 7 payment requests (all above \$600) in our sample for \$900,000 that were paid without submission to the EAO for review or approval.

12. Cease exempting payment requests below \$600 and change order payment request below \$150 from the EAO's review and approval absent a waiver from the Comptroller's Bureau of Accountancy that would allow such an exemption.

HPD Response: “Directive No. 7 allows the Agency to exercise its judgment in developing adequate policies and procedures related to which payment requests are submitted to and review by the EAO prior to payment. It costs the Agency more than \$600 in administrative costs to review a payment, rendering this recommendation impractical and an obvious waste of City resources. The threshold is reasonable and within the EAO's professional judgment, and is allowed under Directive No.7.”

Auditor Comment: In its conduct and response to this audit recommendation, HPD ignores the language and intent of Directive #7 as well as the procedures established by the Bureau of Accountancy for seeking a waiver from requirements contained in

the Comptroller's Directives. Assuming that HPD has a reasonable basis for seeking a waiver, and that it has implemented compensating controls to ensure that the intent of the Directive would not be undermined in the event a waiver were granted, HPD should seek a waiver from the Comptroller's Bureau of Accountancy as recommended. However, we note that HPD did not demonstrate in connection with this audit that any compensating internal controls were in place to ensure that payments made were proper.

13. Implement measures to improve the agency recordkeeping that facilitate clear and accurate accounting of payment requests reviewed and payments processed.

HPD Response: "HPD already has clear policies and procedures related to record keeping and reviews that are consistent with and in compliance with Directive No. 7. The audit compared HPD's list of Financial Management System payments, the primary system that captures vendor payments, to the EAO workload log and found inconsistencies. However, the EAO internal workload log does not impact actual payments to contractors. No payments to contractors were found to be unjustified as a result of the data entry errors within the EAO workload log. HPDInfo is the correct and accurate record of payments made to contractors."

Auditor Comment: HPD misses the point when it states that "the EAO internal workload log does not impact actual payments to contractors." The concern raised by the multiple sets of inconsistent data maintained by the agency is that it appears that 20,838 more construction-related payment requests were processed by HPD during the audit period than the EAO reviewed. Absent a reconciliation of the various data bases maintained by HPD purportedly relating to identical transactions, it is not possible to verify that every required payment request was, in fact, submitted to the EAO for review as required. As stated earlier in this report, HPD has not reconciled its records for the Fiscal Years 2014-2015.

Other Internal Control Weaknesses

Inadequate Policies and Procedures

The EAO's policies and procedures for reviewing payment requests are inadequate. Directive #7 provides audit requirements for each agency EAO to follow; it is each agency's responsibility to develop written policies and procedures that meet its operational needs and comply with the Directive. Although the EAO has written procedures, we found them to be incomplete.¹⁶ Specifically, the EAO lacked procedures for:

- conducting field inspections, with adequate details setting forth the frequency of inspections, the types of documentation necessary, and parameters for determining when a field audit is not feasible;
- change order reviews;
- substantial completion payment request reviews;

¹⁶ The EAO has written procedures to track submitted documents, steps to check the merits of the payment requested, minimal field inspection guidelines, estimating guidelines for work not performed, and options for corrective actions. In addition, the EAO has checklists to aid in reviews of various types of demolition payment requests (based on either "time and material" or "lump sum" contract) and for review of Open Market Orders and capital payment requests.

- payment request summary certifications including retainage withholding reviews;
- time extensions for delayed projects reviews;
- the EAO's role in dispute resolution of questioned payments handled within HPD;
- the EAO's role in prompt payment processing;
- the process to be followed in returning payment requests for further information prior to approval; and
- the process to be followed to evaluate prevailing wage compliance.

In addition, as discussed above, we were informed that HPD has set a threshold below which certain payment requests are not reviewed by the EAO although no basis for the seemingly arbitrary number was tendered. Also, as discussed above, we found numerous payments above the threshold have similarly gone out without required EAO review and approval. Many of the issues we found during the audit, including the EAO's failure to maintain required documentation, may be attributed, at least in part, to the inadequacy of the EAO's policies and procedures.

Overall, the EAO cannot audit payment requests effectively and consistently without adequate policies and procedures that cover all aspects of compliance with Directive #7 and that clearly delineate the compliance responsibilities across the agency. Moreover, the EAO cannot audit payment requests that are not routed to the EAO by HPD divisions responsible for demolition and other construction projects and then paid by HPD's Fiscal Division without the EAO's review and approval. Accordingly, the absence of effective policies, procedures, and fiscal controls for payment requests subject to Directive #7 is a management issue in HPD that extends beyond the EAO itself and requires attention at the executive level.

Lack of EAO Performance Metrics and Issues-Tracking System

HPD does not maintain any analysis of payment requests reviewed by the EAO over a period of time to evaluate whether the EAO's reductions and rejections of payment requests indicate problems with the management of demolition, construction or repairs projects. Such analyses could also be used to monitor the effectiveness and efficiency of the EAO's operation as well. As stated in the Comptroller's primary internal control and accountability directive, Directive #1, *Principles of Internal Control*, "[i]nternal controls must be an integral part of the agency management in satisfying the agency's overall responsibility for successfully achieving its assigned mission and assuring full accountability for its resources." The EAO's reviews could serve as a resource for agency management in assessing the efficiency and accountability of the units responsible for construction, demolition, and repairs, but only if the issues detected through EAO's reviews are properly tracked and analyzed.

According to our analyses, of the 9,268 payment requests totaling \$56,199,371 reviewed by the EAO, the EAO adjusted 279 requests and reduced the total requested amount by \$1,878,365 during the two-year period. Additionally, based on our analysis of the sampled demolition payment-request reviews by the EAO, the reasons for the disallowances and reductions by the EAO included: asbestos quantity adjustments, extra charges for work that was deemed part of original contract scope of work, improper charges for work without required permits, and inadequate supporting documentation. Overall, most of the adjustments appear to result from the Demolition Division's failure to adequately detail the scopes of demolition work in the contracts it awards and its failure to require itemized costs from its contractors, in accordance with the HPD's

Standard Construction Contract, Article 41.¹⁷ Without management's assessment of such information, the agency cannot efficiently evaluate risk areas and assess staffing/resource needs to successfully carry out the EAO's oversight function.

Furthermore, HPD does not track issues raised by the EAO during the EAO's reviews of payment requests. For example, in one case (project #DE00287), the cost of demolition work more than doubled in three weeks' time from the original estimate of \$456,500 to the award amount of \$998,668. While this increase was attributable, at least in part, to an interior collapse and increased asbestos contamination that caused the Department of Buildings (DOB) to elevate the status of the demolition from "emergency" to "immediate emergency," there was no apparent review by HPD of the causes and legitimacy of the rapid increase in the price. Without HPD following up with DOB on issues raised by the EAO and tracking of cost escalation due to worsening site conditions, HPD management cannot ascertain whether this demolition project was effectively managed and whether the risk of cost escalation could extend to other projects.

In other example related to the project to demolish P.S. 31 at 425 Grand Concourse in the Bronx (project #DE00544), the EAO expressed numerous concerns about inadequate documentation to justify bid costs for permits, bonds, site protection, and mobilization totaling \$720,000, which would result in the contractor being paid \$630,000 or more prior to demolishing any part of the building. Further, the EAO was concerned about \$750,000 in the bid costs for demolition of the front part of the building at the 5th floor and the roof. In addition, the EAO questioned what work was covered under one of the bid items for an additional \$850,000. However, no explanations for any of the concerns raised by the EAO were found in the file documentation. Rather, according to the EAO Director, any concerns or issues related to payments were addressed either verbally or sometimes in e-mails with the Assistant Commissioner of Administration, to whom the EAO Director previously reported.

The documents we reviewed and discussions we had with HPD provided no evidence that any issues or concerns raised by the EAO as a result of its reviews were tracked or monitored by HPD. Without any systematic monitoring, tracking of the EAO's reporting of issues, there was no way to determine whether HPD had taken any action or planned to take any action to strengthen the agency's operations based on the EAO's findings and its internal controls, including the EAO's oversight function.

Inappropriate Lines of Reporting

HPD's EAO does not report directly to the Commissioner, or to a Deputy Commissioner, contrary to the requirements of Directive #7, which expressly states that the EAO Director must report directly to the agency head or a deputy agency head assigned by the agency head. Such a reporting structure would help give the EAO independence and the requisite authority to provide more meaningful oversight of the operational divisions.

However, during the audit period, the EAO Director initially reported to the Assistant Commissioner of Administration, who reported to the HPD's First Deputy Commissioner. Since January 2016, the HPD EAO began to report to the agency's Executive Director of Management Review and Engineering Audit, who in turn reports to the Assistant Commissioner of Performance

¹⁷ We found required bid costs breakdowns for only 14 of the 32 sampled payment requests in the Demolition Division files. Standard Construction Contract Article 41 (Bid Breakdown on Lump Sum), requires the contractor to submit within 15 days of notice to proceed, a costs breakdown of its bid price showing various operations to be performed under the contract to be used by HPD for the purpose of reviewing the contractor's application for partial payments based on work progress.

Management and Analytics, who reports to the HPD's First Deputy Commissioner. Neither the current nor the prior reporting structure provides the EAO with adequate authority to ensure the independence of the audit process or communicates the significance of the EAO's role.

No Designated Alternate Engineering Audit Officer

HPD has not designated an alternate EAO Director who is either a New York State registered Professional Engineer or Registered Architect, and has failed to register the name, functional title and signature specimen with the Comptroller's Bureau of Accountancy in accordance with Directive #7, §2.0. A duly authorized designee of the EAO as required by Directive #7 is an important safeguard to ensure that vendor payments are properly reviewed and validated in absence of the designated Engineering Audit Officer (EAO Director).

Recommendations

HPD should:

14. Establish performance metrics for the operation of the EAO.

HPD Response: "The Agency's HPDInfo system maintains the data regarding EAO's reductions and rejections noted on the EAO audit. This system is capable of producing an EAO productivity report and can be used to evaluate EAO operations. Furthermore, significant issues are escalated by HPD EAO to HPD management through phone calls, emails and regular meetings. HPD seeks to continually improve its performance and may review existing operations to consider practical improvements to this process."

Auditor Comment: While HPD asserts that "the system is capable of producing an EAO productivity report," it makes no representation that it has ever run such a report. Moreover, HPD does not state what, if any, performance metrics it uses when and if it runs these reports. Further, we were not provided with any EAO productivity reports and so have no basis upon which to evaluate their possible utility as a monitoring tool.

Additionally, HPD provided no evidence that issues escalated by the EAO were themselves tracked and analyzed by HPD to assess the efficiency and accountability of the units responsible for construction, demolition, and repairs or if any changes were made in HPD's operations as a result of the issues escalated by the EAO. For example, we note that in connection with an issue that the EAO raised concerning a "front-loaded" contract for project #DE00544 involving the demolition of P.S. 31 in the Bronx, HPD did not provide any information about whether it has established controls to mitigate the risk of possible contract front-loading. However, such a contract presents risks because it overstates the cost of work done early in the contract period so that most of the money is paid up front before a corresponding amount of work is actually done. In another example (project #DE00287 which involved the demolition of a 4-story HPD owned building in Brooklyn), as stated in audit, the cost of demolition doubled in three weeks' time from the original estimate because DOB elevated the status of demolition building's condition from "emergency" to "immediate emergency." In its response to the audit findings, HPD did not specifically address whether it followed up with DOB on issues raised by the EAO or comment on whether it has investigated whether there is a risk of similar cost escalations in other projects.

15. Systematically track reasons for reductions and rejections, and monitor issues raised by the EAO that would help the agency improve its internal control environment as well as the EAO's oversight function.

HPD Response: "Significant issues are reported and escalated by HPD EAO to HPD management at regular meetings. HPD seeks to continually improve its performance and may review existing operations to consider practical improvements to this process."

Auditor Comment: HPD did not demonstrate that it tracks the reasons for the EAO's reductions and rejections of payment requests, or that it monitors issues raised by the EAO and evaluates them to help HPD management improve agency's internal controls. We encourage the HPD to engage in such activities on a regular basis.

16. Formulate the demolition work scopes in the contracts that HPD awards in accordance with HPD's demolition specifications established in HPD's Master Guide Specifications for Rehabilitation Projects, or other appropriate standard.

HPD Response: "Formulating scopes is not part of the EAO's mandate as it is not included or mentioned in Directive No.7."

Auditor Comment: Adequate formulation of work scopes is a part of the operations of HPD's capital, demolition, and maintenance units. The proper preparation of work scopes in a consistent manner that include all required elements would reduce ambiguity related to potential cost and schedule overruns, all of what are reviewed by the EAO. As such, this activity has a direct impact on the efficiency and effectiveness of the EAO operations, including potentially reducing occurrences of payment disputes and/or contractor claims, and is appropriately a concern of the EAO.

17. Enforce HPD's Standard Construction Contract Article 41 by requiring demolition and other contractors to submit bid breakdowns within 15 days of HPD's directing them to proceed with contract work.

HPD Response: "Bid breakdowns are provided by demolition contractors as required for assessing programmatic reductions, partial payments, estimating discrepancies, etc."

Auditor Comment: In accordance with the HPD's Standard Construction Contract Article 41, bid breakdowns should have been present in the HPD files for all 32 payment requests (100 percent)—not simply for 14 payment requests (44 percent) as our review found or only "as required" as HPD contends.

18. Ensure that the EAO reports directly to the agency head or a deputy agency head as mandated by Directive #7. Establish an organizational structure that provides adequate authority to the EAO, supports the independence and integrity of the audit process, and provides a mechanism for improving internal controls.

HPD Response: "As of January 2017 the EAO reports directly to the HPD First Deputy Commissioner."

19. Designate an alternate Engineering Audit Officer.

HPD Response: “A professional architect was designated as an Alternate Engineering Audit Officer in 2016.”

DETAILED SCOPE AND METHODOLOGY

We conducted this performance 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter. This audit was conducted by auditors with engineering backgrounds.

The scope of this audit covered payment requests for construction, equipment, and consultant service contracts that were approved for payment under Comptroller's Directive #7 by the HPD's EAO in Fiscal Years 2014 and 2015.

We obtained background information about HPD from the New York City Charter, the Mayor's Management Report, and HPD's website. We reviewed the Comptroller's Comprehensive Annual Financial Report to determine HPD's capital expenditures.

To understand the policies, procedures, and regulations governing the EAO's compliance with Directive #7, we reviewed:

- Comptroller's Directive #7 (*Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services*);
- Comptroller's Directive #1 (*Principles of Internal Control*);
- New York City Procurement Policy Board Rules (PPB Rules);
- HPD's organization charts; and
- Procedures used by the EAO to audit payment requests.

To understand HPD's internal controls for reviewing payment requests and its compliance with Directive #7, we interviewed the EAO Director and EAO supervisors and established types of payment requests, how they were submitted, how they were tracked, and how physical files were maintained. We documented our understanding of these controls in written descriptions.

We interviewed relevant personnel of the various divisions/units (Maintenance, Demolition, Alternative Enforcement Program, and Development) who generate payment requests to be reviewed and approved by the EAO under Directive #7. Additionally, we interviewed the assistant commissioner and the director of accounts payable in the HPD's Fiscal Division who administered payments for requests approved by the EAO.

We documented our understanding of operations in narratives and memoranda, whose accuracy we asked HPD officials to review and confirm. Subsequently, we documented our understanding of the internal controls and assessment of risks of fraud in a memorandum.

HPD provided us with lists of approved payment requests on Excel spreadsheets for Fiscal Years 2014 and 2015.¹⁸ According to these spreadsheets, the EAO audited 9,054 payment requests totaling \$59,026,648 in Fiscal Years 2014 and 2015. In addition, the EAO audited payment

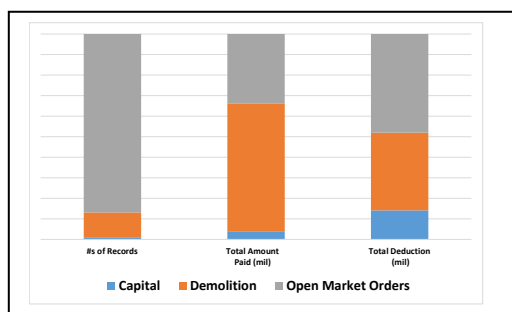
¹⁸ The payment lists included: 1) a list of payments related to Open Market Orders jobs reviewed by the EAO; 2) The EAO spreadsheets of payments related to capital and demolition jobs; and 3) The EAO spreadsheets of change orders reviewed by the EAO.

requests for 214 change orders totaling \$3,318,573. Overall, 9,268 payment requests totaling \$62,345,221 were audited and approved by the EAO.¹⁹

We also requested a list of payments related to Directive #7 from the HPD's Fiscal Division, the division in charge of processing the payments in the City's Financial Management System. In response, we were provided a list of payments encompassing all capital payments (budget object code "400"), which showed that the agency's capital payments totaled \$916.7 million in Fiscal Years 2014 through 2015.²⁰

We conducted tests to ascertain whether the lists of payments requisitions submitted by the agency were complete and accurate. Also, we officially obtained from HPD a statement confirming that the lists provided included all payments under the purview of Directive #7. We followed up with the agency officials for clarifications.

We analyzed the payments requests by types of work (Open Market Orders, demolition work, and capital work) and determined the relevant populations. Of the total 9,054 payments totaling \$59,026,648, there were 7,868 (87%) Open Market Order payment requests totaling \$20,026,781 (34%), 1,098 (12%) demolition payment requests totaling \$36,195,508 (61%), and 88 (1%) capital payments totaling \$2,804,359 (5%). The 214 change orders payment requests totaling \$3,318,573 could not be segregated by types of work.



We selected the Demolition Division payment requests for our audit sample because the division appeared to represent the highest risk area in terms of total dollar amount of payments processed and total adjustments by the EAO compared to the number of payment requests among all three categories of work as illustrated above. In addition, we factored in extent of supporting documentation that should be available in the payment requests files for our review based on the review process explained by the EAO, in the audit sample selection. We sorted the demolition payment requests by contractors with total amounts paid in a descending order, and further subgrouped them by projects. We then selected a sample of two projects from each of the top five contractors. We selected one project where the EAO approved the full requested amount for all underlying payment requests and one project where the EAO reduced the requested amount for at least one of the underlying payment requests to determine whether the HPD's EAO complied with the provisions of Comptroller's Directive #7. We obtained hard copy review files from the agency. Based on the hard copy files documentation, our sample resulted in a total of 36 payment requests. The value of 36 sampled payment requests (32 payment requests for contract work and related 4 change order payment requests) totaled \$10,237,489 which represented 26 percent (\$10.2 million divided by \$39.5 million) of all approved demolition payment requests (\$36.2 million for 1,098 payments and \$3.3 million for 214 change orders) or 16 percent (\$10.2 million divided by \$62.3 million) of all approved payment requests (\$59 million for 9,054 payments and \$3.3 million for 214 change orders).

To determine whether the HPD's EAO complied with Directive #7 requirements, we evaluated the EAO's reporting and organizational structure to determine whether the EAO's independence and

¹⁹ After the exit conference, the amount \$62,345,221 was revised to \$56,199,371 (\$62,345,221 - \$6,145,850) based on the explanations provided by HPD, which resulted in an adjustment of \$6,145,850 to the total audited amount by the EAO for the underlying 9,054 payment requests.

²⁰ We were informed that HPD could not provide a list of payments that would only include Directive #7 related payments.

importance of the audit process is preserved. We assessed the agency's operating practices to determine whether Directive #7's provisions were integrated and they supported the integrity of the audit process. We evaluated the EAO's recordkeeping to ascertain whether they fulfilled the provisions of Directive #7. We evaluated the EAO's written audit procedures to assess whether all Directive #7 requirements were incorporated for the types of payment requests reviewed, and analyzed the EAO spreadsheets data to determine whether the information was accurate.

We examined hard copy file documentation for the sampled payment requests to verify that it contained evidence of the EAO's independent reviews and whether it contained all required documentation. We reviewed all payment requests including payment requests for change orders for the sampled projects that were found in the hard copy files. We determined whether the payment requests were processed within required timeframes. We looked for evidence in the payment files to ascertain whether the EAO conducted field visits when necessary to certify that work performed was sufficiently advanced to warrant payment or evidence of desk audits and justifications to defer field visits were present. We determined whether the EAO verified invoiced quantities and prices by comparing the amount approved for payment with the supporting documentation. To determine compliance with the labor law, we looked for presence of necessary documentation including contractor's daily sign-in sheets and certified payroll reports and examined for evidence of reviews by the EAO. We assessed the sampled payment requests by reviewing amount requested, retention amount, and supporting documentation for work performed.

We also examined change orders that were part of the sampled project payment requests to determine whether the EAO complied with the Comptroller's Directive #7 provisions for "Auditing Contract Changes." We examined the change orders for reviews of validity and cost reasonableness by the EAO. We determined whether these change orders were registered with the Comptroller's Office. We also researched whether there were any claims with the Comptroller's Office filed by contractors associated with the sampled projects. We also reviewed the Standard Construction Contract used by the agency for any applicable requirements.

We obtained from the agency, spreadsheets of all Directive #7 related payments processed according to the agency records. We conducted various analyses to evaluate the agency's recordkeeping. We compared the sampled payments information based on the hard copy files with the payments information as per the EAO records and the information on the agency's information system HPDInfo. Additionally, we analyzed the number of payments and total amounts at types of work as categorized by HPD (demolition work, Open Market Orders, and capital work).

We asked HPD officials to provide us with any documentation missing from the files. We developed our findings and conclusions on the basis of our analyses. The results of our samples were not projected to the entire population; however, our tests results provided a reasonable basis to determine whether the HPD's EAO complied with the provisions of Comptroller's Directive #7.

Sampled Payment Requests and Associated Problems

No.	Project #	Payment #	Approved Amount	Non Compliance with Directive #7 Requirements				
				EAO Approval	Field Audit	Desk Audit	Prevailing Wage Requirements	Prompt Payment Processing per PPB Rules
1	DB00213	1	\$ 136,723	x	x	x	x*	
2	DB00213	2	\$ 44,131	x	x	x	x*	
3	DB00213	3	\$ 32,000	x	x	x	x*	x
4	DB00213	3	\$ 500,308		x	x	x*	
5	DB00213	6	\$ 26,156		x	x	x*	x
6	DB00213	7	\$ 419,339		x	x	x*	
7	DB00213	8	\$ 1,269,360		x	x	x*	
8	DB00214	1	\$ 149,275	x	x	x	x*	
9	DB00214	2	\$ 139,298	x	x	x	x*	
10	DB00214	3	\$ 379,539	x	x	x	x*	x
11	DB00214	3	\$ 2,624		x	x	x*	
12	DB00214	6	\$ 367,448		x	x	x*	x
13	DB00214	7	\$ 983,703		x	x	x*	
14	DB00214	8	\$ 71,860		x	x	x*	
15	DE00287	1	\$ 997,668		x	x	x*	
16	DE00287	2	\$ 500				x*	
17	DE00287	3	\$ 500				x*	
18	DF00229	1	\$ 276,585		x		x*	x
19	DF00229		\$ 3,384					
20	DE00544	1	\$ 30,000		x		x*	x
21	DE00544	2	\$ 1,136,889		x	x	x*	
22	DE00544	3	\$ 1,544,834		x	x	x*	
23	DE00172	1	\$ 118,555		x	x	x*	
24	DE00094	1	\$ 120,000		x	x	x*	
25	DC00021	1	\$ 70,000		x		x*	x
26	DC00021	2	\$ 1,000				x*	
27	DE00356	1	\$ 349,330		x	x	x*	x
28	DE00356	2	\$ 420,170		x	x	x*	
29	DE00356	3	\$ 4,711				x*	x
30	DE00381	1	\$ 3,087					x
31	DE00381	2	\$ 394					
32	DE00381	3	\$ 13,315	x				

Total 32 Sampled Payments (1)	\$9,612,682	x* - were missing daily sign-in sheets			
w/o EAO Approval (2)	\$894,280				
(1) - (2)	\$8,718,402				
Total Questionable Payments (of 25)	\$8,714,624	18	15	22	8
w/o EAO Approval (7 payments)	+ \$894,280	Total Exceptions			
Total Questionable Payments (of 32)	\$9,608,904	7	24	21	28
					10

Problems with HPD's Recordkeeping

	Per Hard Copy files Sampled Payment Requests					Per EAO Spreadsheets				Per HPDInfo system			
No.	Change Order	OMO #	Contractor Name	Pmt. Req. #	Amount Approved per Hardcopy Files	Pmt. Req. #	Amount Approved per EAO Records	Not on EAO Records	Comments*	Pmt. Req. #	Approved Amount per HPDInfo	Not on HPDInfo	Comments*
1		DB00213	Breeze National	1	\$ 136,723			x	Per HPD, EAO approved these payment requests on next payment request and at overall final payment request review.	1	\$ 136,723		
2		DB00213	Breeze National	2	\$ 44,131			x		2	\$ 44,131		
3		DB00213	Breeze National	3	\$ 32,000			x		3	\$ 32,000		
4		DB00213	Breeze National	3	\$ 500,308		\$ 500,308			3	\$ 500,308		
5		DB00213	Breeze National	6	\$ 26,156		\$ 26,156				\$ 26,156		HPD provided a HPDInfo screenshot showing these payment entries.
6		DB00213	Breeze National	7	\$ 419,339		\$ 419,339				\$ 419,339		
7		DB00213	Breeze National	8	\$ 1,269,360		\$ 571,761		Per HPD, previously reported \$5,717,611 amount was incorrect. The payment request for \$1,269,360 was split into two requests (\$571,611 and \$697,599) on the EAO logs.	8	\$ 1,269,360		
		DB00213	Breeze National				\$ 697,599			8	\$ 697,599	x	Additional entry in HPDInfo.
		DB00213	Breeze National							8	\$ 571,761	x	Additional entry in HPDInfo.
8		DB00214	Breeze National	1	\$ 149,275			x		1	\$ 149,275		
9		DB00214	Breeze National	2	\$ 139,298			x		2	\$ 139,298		
10		DB00214	Breeze National	3	\$ 379,539			x		3	\$ 379,539		
11		DB00214	Breeze National	3	\$ 2,624		\$ 2,624			3	\$ 2,624		
12		DB00214	Breeze National	6	\$ 367,448		\$ 367,448				\$ 367,448		HPD provided a HPDInfo screenshot showing these payment entries.
13		DB00214	Breeze National	7	\$ 983,703		\$ 983,703				\$ 983,703		
14		DB00214	Breeze National	8	\$ 71,860		\$ 71,860			8	\$ 71,860		
15	x	DB00213	Breeze National	c/o	\$ 613,041		\$ 348,656			c/o 1	\$ 348,656		
16	x	DB00214	Breeze National	c/o			\$ 264,385			c/o 1	\$ 264,385		
†	x	DB00213	Breeze National	c/o	\$ (41,280)		\$ (20,640)		There appears to be two entries for the change orders totaling \$41,280.			x	An entry for \$20,640 credit change order was not present in HPDInfo.
		DB00214	Breeze National	c/o			\$ (20,640)			c/o 2	\$ (20,640)		
17		DE00287	Gateway Demolition	1	\$ 997,668		\$ 997,668			1	\$ 997,668		
18		DE00287	Gateway Demolition	2	\$ 500		\$ 500			2	\$ 500		
19		DE00287	Gateway Demolition	3	\$ 500		\$ 500			3	\$ 500		
20		DF00229	Gateway Demolition	1	\$ 276,585		\$ 276,585			1	\$ 276,585		
21		DF00229	Gateway Demolition		\$ 3,384		\$ 3,384			Aud Report	\$ 3,384		
22		DE00544	A. Russo Wrecking	1	\$ 30,000		\$ 30,000			1	\$ 30,000		
23		DE00544	A. Russo Wrecking	2	\$ 1,136,889		\$ 1,136,889			2	\$ 1,136,889		
24		DE00544	A. Russo Wrecking	3	\$ 1,544,834				Per HPD, subsequent payments were approved at a later date.	3	\$ 1,544,834		
		DE00544	A. Russo Wrecking				\$ -			c/o 1	\$ -		Per HPD, it was not a \$0 change order entry. It is a HPDInfo generated placeholder entry for the cancelled change order.
	x	DE00544	A. Russo Wrecking	c/o	\$ 8,055		\$ 8,055			c/o 2	\$ 8,055		
25		DE00172	A. Russo Wrecking	1	\$ 118,555		\$ 111,855		Per HPD, previously reported \$1,118,555 amount was incorrect. The correct amount should have been \$118,855.	1	\$ 118,555		

Problems with HPD's Recordkeeping (Cont.)

No.	Per Hard Copy files Sampled Payment Requests					Per EAO Spreadsheets				Per HPDInfo system			
	Change Order	OMO #	Contractor Name	Pmt. Req. #	Amount Approved per Hardcopy Files	Pmt. Req. #	Amount Approved per EAO Records	Not on EAO Records	Comments*	Pmt. Req. #	Approved Amount per HPDInfo	Not on HPDInfo	Comments*
26		DE00545	A. Russo Wrecking							c/o 3	\$ -		Per HPD, it was not a \$0 change order entry. It is a HPDInfo generated placeholder entry for the cancelled change order.
27		DE00094	N. B. I. Equipment	1	\$ 120,000		\$ 120,000			1	\$ 120,000		
28		DC00021	N. B. I. Equipment	1	\$ 70,000		\$ 70,000			1	\$ 70,000		
29		DC00021	N. B. I. Equipment	2	\$ 1,000		\$ 1,000			Aud Report	\$ 1,000		
30		DE00356	RD2 Construction and Demolition	1	\$ 349,330		\$ 349,330			1	\$ 349,330		
31		DE00356	RD2 Construction and Demolition	2	\$ 420,170		\$ 420,170			2	\$ 420,170		
32		DE00356	RD2 Construction and Demolition	3	\$ 4,711		\$ 4,711			3	\$ 4,710		
33	x	DE00356	RD2 Construction and Demolition	c/o	\$ 3,711		\$ 3,710			c/o 1	\$ 3,711		
34		DE00381	RD2 Construction and Demolition	1	\$ 3,087		\$ 3,087			Aud Report	\$ 3,087		
35		DE00381	RD2 Construction and Demolition	2	\$ 394		\$ 394			Aud Report	\$ 394		
36		DE00381	RD2 Construction and Demolition	3	\$ 13,315			x	No explanation was provided.			x	No entry was present in HPD Info

5	Total	\$ 10,196,209	\$ 7,832,955	7	\$ 11,514,173	4
* Comments after the exit conference			\$ (2,363,254) Difference between hard copy files and EAO records		\$ 1,317,964 Difference between hard copy files and HPDInfo	
	Entries updated after the exit conference	\$ 894,280	Total of 7			
	Additional information	\$ 1,269,360	Total of 2			
	Missing information	\$ 33,955	Total for 2			
†	After the exit conference, HPD provided a credit change order for \$41,280. However, the EAO approval stamp was not present on the document.					



City of New York
DEPARTMENT OF
HOUSING PRESERVATION AND DEVELOPMENT
100 GOLD STREET, NEW YORK, N.Y. 10038
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MARIA TORRES-SPRINGER
Commissioner

March 6, 2017

Marjorie Landa
Deputy Comptroller for Audit
Office of the New York City Comptroller
One Centre Street, Room 1100 New York, New York 10007

Re: Audit Report on the Department of Housing Preservation and Development Engineering
Audit Office's Compliance with Comptroller's Directive No. 7 SE15-119A

Dear Deputy Comptroller Landa,

Thank you for the opportunity to respond to your Audit Report on the Department of Housing Preservation and Development Engineering Audit Office's Compliance with Comptroller's Directive No. 7 (the "Audit Report"). We have carefully considered the Audit Report and disagree with the vast majority of the findings and recommendations. Directive No. 7 explicitly allows for discretion in the implementation of requirements related to the types of emergency work that were the subject of this audit, and HPD is in compliance with the Directive.

The audit report is flawed. HPD's demolition jobs are mostly emergency situations not specifically addressed in Directive No. 7, and the agency's Engineering Audit Office (EAO) exercised the authority granted through section 3.1.2 of the Directive to utilize professional judgement in the development of effective and efficient audit operations to meet the goals of the Directive. All payments approved by the EAO were justified, followed Procurement Policy Board (PPB) rules, and there were no overpayments.

The auditors rejected valid evidence from HPD showing that desk audits and field visits were conducted, ignored evidence that photographs were stored electronically by job address, and failed to acknowledge that HPD's Labor Monitoring Unit handles all agency prevailing wage matters.

Consistent with guidelines of Directive No. 7, HPD's Engineering Audit Office (EAO) exercising its professional judgment in administering a thorough audit program appropriate for HPD's demolition and emergency repair work. HPD's demolition work typically involves short-term, emergency, stand-alone jobs that are not phases of larger construction contracts. As required by Directive No.7:

- HPD's EAO conducts and documents desk audits following checklists that detail verification steps.



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- HPD's EAO conducts and documents field inspections to determine if the scope of work has been completed in a satisfactory manner and in compliance with applicable codes and regulations. Field inspections are documented through daily route sheets and time-stamped photographs that are electronically filed in a prescribed manner.
- HPD's EAO documents the approval or denial of payments. EAO approved payment requests are stamped and signed by the EAO. If the EAO contests any aspect of the payment request, an audit report is produced by the EAO with an itemized assessment of each item.
- HPD's Labor Monitoring Unit (LMU) is staffed with professionals who are best equipped to ensure all prevailing wage requirements are met; LMU investigates issues whenever necessary. No payments for prevailing wage jobs are released by the EAO without LMU's approval.
- HPD's Fiscal Unit ensures that Prompt Payment Rules are followed, as per the PPB rules. The payments are made within the 30-day allowable time period or 60 days for substantial completion of job or final payments on construction contracts. Time extensions are permitted if required payrolls are not submitted or EAO adjustments are made to reduce the approved payment amount.

In sum, HPD's EAO is in compliance with Directive No. 7, and utilizes policies and procedures that are consistent with the goals of the Directive and appropriate for the type of work the agency does.

Once again, thank you for providing the opportunity to comment upon the Audit Report. I am happy to discuss our response with you further.

Sincerely,



Maria Torres-Springer



Agency Response to NYC Comptroller Audit Report on HPD's Engineering Audit Office's Compliance with Comptroller's Directive No. 7 – SE15-119A
March 6, 2017

We have carefully reviewed the Audit Report, and disagree with the vast majority of the findings and recommendations. HPD's Engineering Audit Office (EAO) is in compliance with Comptroller's Directive No. 7 (Directive), which explicitly allows the EAO to utilize professional judgment in the development and execution of audit procedures depending on the nature of the work or project, the type of payment requested, and the state of work completion.

HPD's demolition and emergency repair work are not phases of larger construction contracts. They are short-term, stand-alone jobs typically performed in response to emergency situations not specifically addressed in the Directive. In such situations, the Directive clearly states that the EAO is expected to exercise professional judgment, consistent with the intent of these guidelines, to determine the nature and extent of the audit procedures necessary for evaluating the payment request under review.¹ Using that discretion, HPD's EAO has developed a thorough and rigorous program of effective and efficient audit operations for HPD's demolition and emergency repair work, which meets the goals of the Directive.

In administering this program, the EAO staff performs field inspections to determine if the scope of work has been completed in a satisfactory manner and in compliance with applicable codes and regulations. During desk audits, the EAO staff follows detailed checklists to review documentation submitted by the contractors and other administrative information (for example, information from the Departments of Buildings, Transportation, and Environmental Protection). During the review of change orders, if the EAO determines a reduced payment amount from the invoice is necessary, the information is recorded in HPDInfo.

HPD maintains evidence of field inspections, time stamped photographs, and observations of the demolition site in either hard copy or electronic form. EAO does not keep duplicative records of files that are found in the Demolition Unit; only information that supports deductions, litigation and claim disputes are kept in EAO project files. HPD's electronic filing system stores the time-stamped photographs and daily site inspection route sheets. The EAO has access to Demolition Unit files as needed.

Independently, the agency's Labor Monitoring Unit (LMU) is staffed with professionals who work to ensure that all prevailing wage requirements are met and issues are investigated whenever necessary. No payments for prevailing wage jobs are released without LMU's approval. The agency's Fiscal Unit ensures that Prompt Payment Rules are followed, in accordance with Procurement Policy Board (PPB) rules. The payments are made within the 30-day allowable time period or 60 days for substantial completion of job or final payments on construction contracts, including time extensions allowed due to lack of required payroll submissions and EAO adjustments to reduce the invoice.

In our view, the Audit Report is flawed because the auditors failed to appreciate how stand-alone demolition work differs from typical multi-phased construction projects, rejected valid evidence from

¹ Directive No.7 -3.1.2 EAO Judgment states, in pertinent part:

In situations not specifically addressed herein, the EAO is expected to exercise professional judgment, consistent with the intent of these guidelines, to determine the nature and extent of the audit procedures necessary for evaluating the payment request under review. In such instances, the EAO may add to, modify or omit audit steps as he or she deems appropriate.

HPD showing that desk audits and field visits were conducted, ignored evidence that photographs were stored electronically by job address, and failed to acknowledge that HPD's LMU handles all of the agency's prevailing wage matters.

Agency's Position on the Audit's Methods, Findings and Recommendations

The audit's 19 recommendations are either not appropriately tailored to HPD's operations, have already been implemented, or are not within the scope of Directive No. 7.

Agency's Position

- HPD EAO reviewed all 32 of the payments that constituted the auditors' sample and found all were justified. Furthermore, EAO staff conducted field inspections. The Agency maintains that there were no overpayments to contractors.
- The Agency disputes the questioned payments totaled \$9.6 million. The auditors' strict interpretation of the Directive incorrectly imposed a standard for required documentation that does not exist or was never communicated to the agency prior to the audit. Furthermore, the auditors dismissed the agency's valid evidence of field inspections and concluded, erroneously, that those inspections did not happen.
- The Agency's existing controls are effective and were responsible for identifying initial payment requests from a large one-time contract did not follow standard HPD EAO procedures. In that instance, HPD determined early payments totaling \$880,966 (a subset of the \$9.6 million) had to be routed back to the EAO for secondary review and ensured that the EAO reviewed all future payment requests. After additional reviews, as required prior to the final payment, EAO found all payments were justified and there were no improper payments.
- The Audit Report's contention that HPD did not manage prevailing wage requirements is false. HPD's LMU is staffed with professionals who are best equipped to ensure all prevailing wage requirements are met and issues are investigated whenever necessary. No payments for prevailing wage jobs are released without LMU's approval.
- The auditors incorrectly identified payments that did not meet prompt payment standards. The eight sample payments in question were paid within the time allowed, including allowable time for extensions according to Prompt Payment provisions under the PPB Rules. HPD provided the auditors with documentation from the Financial Management System and HPDInfo proving that these payments were not due interest in accordance with the PPB Rules.
- Desk Audits are performed as an integral part of the field audit on single payment demolition jobs. On multiple payments jobs similar to one-time intra-government jobs, evaluation is based on the bid breakdown and field visits.

Agency Specific Responses to Audit Recommendations

HPD should:

1. Develop complete written EAO review policies and procedures that assure complete and consistent EAO recordkeeping and reviews in accordance with Directive No. 7

Agency Response 1: HPD is in compliance with Directive No. 7 requirements to have adequate policies and procedures related to record keeping and reviews. Procedures and checklists provided to auditors were developed based on the EAO's professional judgment and are appropriate for review of invoices.

2. Ensure that the EAO's policies and procedures include frequency and timing of field visits to physically verify requested payment amounts

Agency Response 2: HPD is in compliance with Directive No. 7 requirements for adequate policies and procedures related to record keeping and reviews. Written procedures and checklists for field visits were developed based on the EAO's professional judgment and were provided to auditors.²

3. Ensure that the EAO conducts field visits to physically verify requested payment amounts and adequately documents the results of the field visits in accordance with Directive No. 7

Agency Response 3: HPD is in compliance with Directive No. 7 requirements. EAO inspectors completed field visits following existing procedures for the 18 sampled payments and documentary evidence was provided to auditors. The existing procedures and documentation were developed based on the EAO's judgment, and are consistent with Directive No. 7.

4. Ensure that the EAO records reasons why field audits were not conducted in the cases when payments were authorized based solely on desk audits

Agency Response 4: HPD is in compliance with Directive No. 7 requirements. EAO inspectors went on field visits for the 18 sampled payments as mentioned in *Agency Response 3*. Therefore, desk audits were not the sole basis for the payments approved by EAO.

5. Ensure that the EAO's prevailing wage compliance procedures include all tests required by Directive 7, including but not limited to comparing contractors' daily sign-in sheets with other records specified in the directive, or, alternatively, if the EAO relies on HPD's Labor Law Compliance Unit to obtain relevant information, that the Labor Law Compliance Unit (LMU) conducts all of the tests required by Directive No. 7

Agency Response 5: HPD is already in compliance with Directive No. 7. The assertion that HPD did not manage compliance with prevailing wage rules is false. HPD has a dedicated labor monitoring unit as described above and the EAO depends on the expertise of the professional labor monitoring staff. No payments for prevailing wage jobs are released without LMU's approval.

6. Ensure that the EAO conducts independent reviews of prevailing wage requirements to confirm whether contractors are in compliance with all prevailing wage requirements or seek a waiver from the Comptroller's Bureau of Accountancy with respect to delegating responsibility of conducting tests for compliance with the prevailing wage requirements from the EAO to the agency's Labor Law Compliance Unit

Agency Response 6: HPD has a dedicated labor monitoring unit and EAO depends on the expertise of the professional labor monitoring staff in HPD's Labor Monitoring Unit. No payments for prevailing wage jobs are released without LMU's approval.

² Directive No. 7- 3.2.1 Field Visit Frequency and Timing:

The frequency of field visits may vary according to factors such as the type of contract and the size and complexity of the project. Generally, field visits are to be conducted whenever the payment request is based upon work performed, subject to the provisions below. The proper timing of field visits is essential in order to discover errors, flawed construction and other problems before their detection would be precluded by subsequent activity. However, the EAO and staff may defer a field visit when it is not reasonably practicable to conduct a timely field audit, and when, in his or her professional judgment, the nature of the work for which payment is sought permits verification on a subsequent visit.

7. Ensure that the EAO maintains complete review records including desk audit reports, field audit reports and other substantiating documentation

Agency Response 7: HPD already has thorough and rigorous policies and procedures related to record keeping and reviews. Per EAO's judgment the Agency's present documentation is consistent and in compliance with Directive No. 7.

8. Ensure that payments are processed in accordance with the PPB prompt payment provisions

Agency Response 8: HPD is already in compliance with Directive No. 7 requirements. Documentation from the Financial Management System and HPDInfo was provided to the auditors, proving that these payments were not due interest in accordance with the PPB Rules. The Fiscal Unit ensures that Prompt Payment Rules are followed, as per the PPB rules. The payments are made within the 30-day allowable time period or 60 days for substantial completion of job or final payments on construction contracts, including time extensions allowed due to lack of required payroll submissions and EAO adjustments to reduce the invoice according to PPB Rules, Section 4-06.³

9. Ensure that all change order requests are timely submitted to the EAO for an independent determination of their validity and cost reasonableness

Agency Response 9: The Agency's existing policy is for the EAO to pre-approve change orders before starting additional work.

10. Develop and distribute written policies and procedures that clearly set forth processes across the agency to ensure compliance with Directive No. 7 and that reinforce the EAO's role and authority

Agency Response 10: HPD already has thorough and rigorous policies and procedures related to record keeping and reviews.

11. Ensure that all required payment requests are submitted to and reviewed by the EAO prior to any payments being made

Agency Response 11: HPD exercises its judgment in compliance with Directive No. 7 requirements for policies and procedures relating to which payment requests are submitted to and reviewed by the EAO prior to payment. The Agency policy is for the HPD EAO to review payments of \$600 and above. The threshold is based on the EAO's analyses of the type and dollar amount of the payments, and was introduced years ago to ensure the most efficient use of public resources. Invoices under \$600 are mostly no access fees and small repairs, and in fiscal year 2014-5, represented 72% of the payments. HPD's policy enables the EAO to focus on

³ Directive No.7 - Section 4-06 Prompt Payment (c)(2)(iii)

...indicates that in the case of substantial completion or final payments on construction contracts, sixty days is allowed for prompt payment. Section 4-06 (c)(3) indicates that an extension of the required payment date is allowed to satisfy or rectify issues prohibiting prompt payment including but not limited to Comptroller issues with the payment(EAO cuts)and necessary appropriation required to authorize payment (registration). Section 4-06 (c) (4) indicates that a proper invoice is required to initiate payment (submission of proper payrolls).

auditing the invoices for work over \$600, which represented 93% of the value of total payment amounts in the audit time period.

12. Cease exempting payment requests below \$600 and change order payment request below \$150 from the EAO's review and approval absent a waiver from the Comptroller's Bureau of Accountancy that would allow such an exemption

Agency Response 12: Directive No. 7 allows the Agency to exercise its judgment in developing adequate policies and procedures related to which payment requests are submitted to and review by the EAO prior to payment. It costs the Agency more than \$600 in administrative costs to review a payment, rendering this recommendation impractical and an obvious waste of City resources. The threshold is reasonable and within the EAO's professional judgment, and is allowed under Directive No. 7.

13. Implement measures to improve the agency recordkeeping that facilitate clear and accurate accounting of payment requests reviewed and payments processed

Agency Response 13: HPD already has clear policies and procedures related to record keeping and reviews that are consistent with and in compliance with Directive No. 7. The audit compared HPD's list of Financial Management System payments, the primary system that captures vendor payments, to the EAO workload log and found inconsistencies. However, the EAO internal workload log does not impact actual payments to contractors. No payments to contractors were found to be unjustified as a result of the data entry errors within the EAO workload log. HPDInfo is the correct and accurate record of payments made to contractors.

14. Establish performance metrics for the operation of the EAO

Agency Response 14: The Agency's HPDInfo system maintains the data regarding EAO's reductions and rejections noted on the EAO audit. This system is capable of producing an EAO productivity report and can be used to evaluate EAO operations. Furthermore, significant issues are escalated by HPD EAO to HPD management through phone calls, emails and regular meetings. HPD seeks to continually improve its performance and may review existing operations to consider practical improvements to this process.

15. Systematically track reasons for reductions and rejections, and monitor issues raised by the EAO that would help the agency improve its internal control environment as well as the EAO's oversight function

Agency Response 15: Significant issues are reported and escalated by HPD EAO to HPD management at regular meetings. HPD seeks to continually improve its performance and may review existing operations to consider practical improvements to this process.

16. Formulate the demolition work scopes in the contracts that HPD awards in accordance with HPD's demolition specifications established in HPD's Master Guide Specifications for Rehabilitation Projects, or other appropriate standard

Agency Response 16: Formulating scopes is not part of the EAO's mandate as it is not included or mentioned in Directive No. 7.

17. Enforce HPD's Standard Construction Contract Article 41 by requiring demolition and other contractors to submit bid breakdowns within 15 days of HPD's directing them to proceed with contract work

Agency Response 17: Bid breakdowns are provided by demolition contractors as required for assessing programmatic reductions, partial payments, estimating discrepancies, etc.

18. Ensure that the EAO reports directly to the agency head or a deputy agency head as mandated by Directive No. 7. Establish an organizational structure that provides adequate authority to the EAO, supports the independence and integrity of the audit process, and provides a mechanism for improving internal controls

Agency Response 18: As of January 2017 the EAO reports directly to the HPD First Deputy Commissioner.

19. Designate an alternate Engineering Audit Officer

Agency Response 19: A professional architect was designated as an Alternate Engineering Audit Officer in 2016.