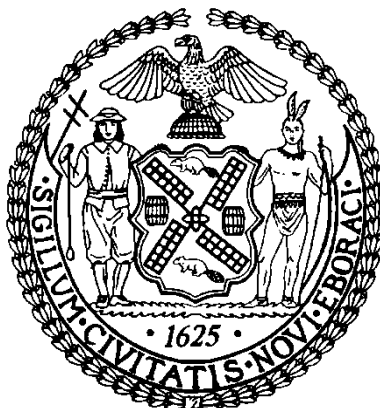


CITY OF NEW YORK OFFICE OF THE COMPTROLLER

**John C. Liu
COMPTROLLER**

FINANCIAL AUDIT

**Tina Kim
Deputy Comptroller for Audit**



Audit Report on the Department of Housing Preservation and Development's Administration of Its 8A Section 17 Account

FM12-083A

December 27, 2011



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

John C. Liu
COMPTROLLER

December 27, 2011

To the Residents of the City of New York:

My office has audited the Housing Preservation Development's (HPD) administration of its 8A Section 17 bank account to determine whether HPD administered the account in accordance with applicable rules and regulations. We audit entities such as HPD as a means of ensuring that they comply with established policies and procedures.

In 1985, Housing Preservation and Development (HPD) received permission from the New York City Department of Finance (DOF) to establish a bank account in order to make loans available to homeowners through the 8A Loan Program which was originally federally funded. The audit found that HPD does not properly administer its 8A Section 17 account. As of October 2010, HPD maintained nearly \$17 million in funds administered under various loan programs that were not used and should have been returned to the City unrestricted. Previously, these funds would revert directly back to the City. However, since 2007, these funds have been redirected to this account. The accumulation of funds allocated to this account may affect the budget and finances of the City because they are not available for other purposes.

Furthermore, an undetermined amount of these funds do not comply with the original purpose of the account because they belong to other programs outside of the 8A Loan Program and are not federal funds. Specifically, HPD does not have a breakdown of which funding sources and programs compose the balance. Inadequate and incomplete recordkeeping has resulted in the commingling of funds that belong to different funding sources and programs.

The audit recommends that HPD determine the exact composition of the account balance. In addition, HPD should transfer and unrestrict the \$16.9 million, less any funds claimed by another funding source, from the 8A Section 17 account to the general fund/capital fund and return the funds to their appropriate budget codes in the Financial Management System (FMS) and if needed, seek assistance from the Comptroller's Bureau of Accountancy for guidance on how to account for prior-year funds using FMS.

The results of the audit have been discussed with HPD officials, and their comments have been considered in preparing this report. Their complete written responses are attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at audit@Comptroller.nyc.gov or call my office at 212-669-3747.

Sincerely,



John C. Liu

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***The City of New York
Office of the Comptroller
Financial Audit***

**Audit Report on the
Department of Housing Preservation and Development's
Administration of Its 8A Section 17 Account
FM12-083A**

AUDIT REPORT IN BRIEF

In 1985, Housing Preservation and Development (HPD) received permission from the New York City Department of Finance (DOF) to establish a bank account in order to make loans available to homeowners through the 8A Loan Program which was originally federally funded. Currently, the Article 8A Loan Program provides rehabilitation loans to correct substandard or unsanitary conditions and to prolong the useful life of multiple dwellings in New York City. As of October 2010, HPD maintained \$16.9 million in the 8A Section 17 account. Currently, HPD utilizes the 8A Section 17 account to hold unspent funds from previously issued loans. According to HPD, the balance in the account is composed of funds from several different loan programs, including but not limited to, the Neighborhood Entrepreneur Program and the Neighborhood Redevelopment Program.

Audit Findings and Conclusions

HPD did not properly administer its 8A Section 17 account. As of October 2010, HPD maintained nearly \$17 million in funds administered under various loan programs that were not used and should have been returned to the City unrestricted. Previously, these funds would revert directly back to the City and not the 8A Section 17 account. However, since 2007, these funds have been redirected to this account. The accumulation of funds allocated to this account may affect the budget and finances of the City because they are not available for other purposes. Furthermore, an undetermined amount of these funds do not comply with the original purpose of the account because they belong to other programs outside of the 8A loan program and are not federal funds. The exact amount allocated to these other programs could not be determined because HPD does not have a full accounting of the funding. Specifically, HPD does not have a breakdown of which funding sources and programs compose the balance. Inadequate and incomplete recordkeeping has resulted in the commingling of funds that belong to different funding sources and programs.

Audit Recommendations

HPD should:

- Determine the exact composition of the account balance.
- Transfer and unrestrict the \$16.9 million, less any funds claimed by another funding source, from the 8A Section 17 account to the general fund/capital fund and return the funds to their appropriate budget codes in the Financial Management System (FMS). If needed, seek assistance from the Comptroller's Bureau of Accountancy for guidance on how to account for prior-year funds using FMS.

Agency Response

HPD did not dispute the audit's findings and agreed with the two recommendations.

INTRODUCTION

Background

HPD is the largest municipal developer of affordable housing in the nation. Since 1987, HPD has provided over \$8.7 billion to support the repair, rehabilitation, and new construction of housing units. HPD also protects the existing housing stock and expands housing options for New Yorkers, improving the availability, affordability, and quality of housing in New York City.

In 1985, HPD received permission from DOF to establish a bank account in order to make loans available to homeowners through the 8A Loan Program, which was originally federally funded. Funds are placed in what is referred to as a Pool and Satellite or zero balance account. Essentially, the bank account operates with a zero dollar balance, while the funds remain in the City's treasury, restricted for the purpose HPD stated when it requested permission to open the bank account. When funds are needed, checks are processed and automatic dollar transfers are made to cover the disbursement from the Pool and Satellite account. Currently, the Article 8A Loan Program provides rehabilitation loans to correct substandard or unsanitary conditions and to prolong the useful life of multiple dwellings in New York City.

As of October 2010, HPD maintained \$16.9 million in the 8A Section 17 Account. Currently, HPD utilizes the 8A Section 17 account to hold unspent funds from previously issued loans. According to HPD, the balance in the account is composed of funds from several different loan programs, including but not limited to, the Neighborhood Entrepreneur Program and the Neighborhood Redevelopment Program.

Objective

Our audit objective was to determine whether HPD administered its 8A Section 17 account in accordance with applicable rules and regulations.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). 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.

The scope of this audit was July 1, 2009, through October 31, 2010. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

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 officials and discussed at an exit conference on November 21, 2011. On December 5, 2011, we submitted a draft report to HPD officials with a request for comments. We received a written response from HPD officials on December 19, 2011.

HPD did not dispute the audit's findings and agreed with the two recommendations. HPD officials stated that "HPD will continue to work to determine the exact composition of the account balance." HPD officials further stated that, "HPD is currently working with the Office of Management and Budget (OMB) to determine treatment of these funds.... Once HPD and OMB make a determination on the treatment of these funds, HPD will transfer the said funds to the general fund/capital fund and appropriate Financial Management System (FMS) budget/revenue codes."

Although HPD officials agreed with the audit's two recommendations, HPD needs to correct this situation immediately. It has already taken HPD five years to determine how to account for unused construction loan balances. Nonetheless, if HPD officials are serious in correcting this issue, they should contact the Comptroller's Bureau of Accountancy for assistance.

FINDINGS AND RECOMMENDATIONS

HPD did not properly administer its 8A Section 17 account. As of October 2010, HPD maintained nearly \$17 million in funds administered under various loan programs that were not used and should have been returned to the City unrestricted. Previously, these funds would revert directly back to the City and not the 8A Section 17 account. However, since 2007, these funds have been redirected to this account. The accumulation of funds allocated to this account may affect the budget and finances of the City because they are not available for other purposes. Furthermore, an undetermined amount of these funds do not comply with the original purpose of the account because they belong to other programs outside of the 8A loan program and are not federal funds. The exact amount allocated to these other programs could not be determined because HPD does not have a full accounting of the funding. Specifically, HPD does not have a breakdown of which funding sources and programs compose the balance. Inadequate and incomplete recordkeeping has resulted in the commingling of funds that belong to different funding sources and programs.

Nearly \$17 Million Improperly Held in 8A Section 17 Account

Since 2007, HPD has been redirecting unused loan funds and interest from several different loan programs to the 8A Section 17 account. Prior to 2007, unused funds would be returned directly to the City. However, according to HPD officials, the Mayor's Office of Management and Budget (OMB) instructed HPD to redirect funds to this account because the City lacked an adequate mechanism to account for unused loan funds. HPD officials also stated that this arrangement is temporary until HPD and OMB determine how to "treat deposits of this nature." However, this process does not appear temporary. The account's balance as of October 2010 was nearly \$17 million. The book balance in the account as of the start of Fiscal Year 2007 was only \$2.4 million and has steadily increased to the \$17 million balance as of October 2010.

HPD is establishing a large reserve of cash by accumulating unused loan funds. Excess funds that are not used affect the City's cash flow. Accumulating the amount of cash that is allocated to the account may directly affect the finances of the City because the use of the funds as allocated is restricted and cannot be re-appropriated for other purposes.

Furthermore, according to DOF records, the account was only authorized to make loans to homeowners through the federally funded 8A program. However, now the account is being used for other purposes. According to HPD officials, the account is being used as a holding account and contains mostly City capital funds derived from various other loan programs. At present, funds are allocated to the account under the label of the 8A program, which appears to constitute a fraction of the total balance. Due to HPD's insufficient recordkeeping, the exact breakdown of funding sources and programs that compose the balance is unknown. In addition to the excessively large balance maintained, there is now a lack of transparency because the account is being used for purposes other than those authorized by DOF. Consequently, HPD has built up a huge reserve which may not be subject to the City's budget process.

Inadequate Recordkeeping **Results in Commingling of Funds**

Based on our review of HPD's ledgers and discussions with HPD officials, HPD's recordkeeping is incomplete and inadequate. HPD could not provide a breakdown of the composition of the 8A Section 17 account. Specifically, HPD pooled funds in the account without maintaining separate subledgers detailing balances allocated to different programs and funding sources. Therefore, HPD can only estimate the account's composition and cannot provide specific dollar figures. This has resulted in a commingling of funds. According to HPD, "We are working on an analysis of the programs with balances within the Section 17 account."

In addition, HPD stated that "The loan projects and/or program names for which unspent funds were deposited during the audit period were delineated and included on the activity ledger previously provided to you." There are also issues with this statement. According to the ledgers, between July 1, 2009, and October 31, 2010, HPD processed six deposits totaling \$553,571, and nine withdrawals totaling \$199,802, which lacked a description of the source or destination of the funds. Although HPD subsequently provided documentation supporting each entry, the lack of a description on the ledgers could result in the misuse of funds.

For example, HPD issued nine \$50 checks from the 8A Section 17 account totaling \$450. For these transactions, HPD's ledgers did not disclose the recipients of the funds. A review of the cancelled checks and supporting documentation revealed the payments were stipend checks made to Section 8 Resident Advisory Board members—completely unrelated to loans or the purpose of the account. Although HPD later reimbursed the account, allowing transactions to be recorded with blank descriptions on the ledgers increases the risk that error or fraud could occur.

Recommendations

HPD should:

1. Determine the exact composition of the account balance.

HPD Response: "The Pool and Satellite account operates with a zero balance while the funds remain in the City's Treasury. HPD prepares monthly bank reconciliation statements and also submits the June's reconciliation (annually) to the Comptroller's Division of Accounting Compliance. In addition to reconciling monthly to internal records, HPD reconciles to the Central Pool Worksheet Balance report of the Department of Finance, Bureau of Treasury.

"HPD has provided timely documentation to substantiate all deposits/disbursements questioned. HPD maintains records of bank reconciliations, checks, account ledger, and other supporting documentation to substantiate the transactions in this account. HPD will continue to work to determine the exact composition of the account balance."

Auditor Comment: As a responsible custodian of these funds, HPD should have had a complete accounting of these funds, including funding sources, from the start. Given the current economic state of the City, HPD should immediately determine the exact composition of these funds so that funds can be released from the account after HPD, OMB and the Comptroller's office Bureau of Accountancy decide on how to properly account for these funds.

2. Transfer and unrestrict the \$16.9 million, less any funds claimed by another funding source, from the 8A Section 17 account to the general fund/capital fund and return the funds to their appropriate budget codes in FMS. If needed, seek assistance from the Comptroller's Bureau of Accountancy for guidance on how to account for prior-year funds using FMS.

HPD Response: "This account is currently used to temporarily hold unspent funds returned to the agency from previously issued construction loans. HPD is currently working with the Office of Management and Budget (OMB) to determine treatment of these funds. While these discussions are ongoing, HPD has opted to use the account to bring funds into the City's control, rather than leaving them at banks.

"Once HPD and OMB make a determination on the treatment of these funds, HPD will transfer the said funds to the general fund/capital fund and appropriate Financial Management System (FMS) budget/revenue codes. Some funds are appropriate for immediate deposit, in which case HPD has taken them out of the account and allocated them appropriately. The balance on the Section 17 account is \$13.9 million as of December 2011, demonstrating our progress."

Auditor Comment: Although HPD claims that it is in the process of working with OMB to determine the treatment of these funds, it has yet to come up with a solution after five years. Consequently, a huge balance has accumulated at the expense of other City priorities. Further, HPD should have never used this account to hold these funds. Nonetheless, if HPD is serious about correcting this issue, they should contact the Comptroller's Bureau of Accountancy for assistance.

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). 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.

The scope period of this audit was July 1, 2009, through October 31, 2010. To achieve our objectives, we reviewed Comptroller's Directive #1, "Principles of Internal Control," Comptroller's Directive #11, "Cash Accountability and Controls," Comptroller's Directive #27, "Fiduciary Accounts: Procedures for Requesting, Controlling and Monitoring," and Comptroller's Office Memorandum 92-12: "Use of Personal Bank Accounts for City Business."

To gain an understanding of HPD's 8A Section 17 account, we reviewed HPD's operating bank account procedure, Description of Operating Bank Accounts, and the account's authorization letter from DOF. To gain an understanding of the controls in place, we conducted a walk-through of the Accounts Payable Department. We interviewed HPD directors and officials from the Fiscal and Budget Department. We documented the interviews through written narrative. We also created a spreadsheet that identifies employees and their responsibilities over the account. This spreadsheet was analyzed to determine whether HPD properly segregated duties that mutually pose potential risk of error or fraud.

To conduct our testing, we judgmentally sampled the month with the largest total disbursement (\$2,987,014-October 2010), out of total disbursements of \$4,744,945 for the audit period. To identify the month with the largest total disbursement, we used HPD's monthly bank reconciliations and compiled a spreadsheet indicating all disbursements. To determine whether the information from the bank reconciliations was accurate and reliable, we randomly selected one month (August 2009) and obtained the bank statement. We compared the disbursements and deposits presented on the randomly selected bank statement to HPD's bank reconciliation. Due to the nature of a Pool and Satellite account, the bank statements reported a zero balance. Therefore, we also utilized the DOF's Pool and Satellite Cash Management report to verify the balances reported on the reconciliation report. Based on our procedures, we believe we have obtained reasonable assurance that the data provided by HPD is complete and accurate.

To determine whether HPD's controls over the 8A Section 17 account were operating effectively, we initially reviewed HPD's list of authorized signatories and compared the signatures to those on the checks issued in October 2010. We also determined whether the proper preparer and supervisor signed and dated the bank reconciliation. To determine whether HPD processed disbursements in accordance with the original purpose of the account, we reviewed each transaction (12) supporting the \$2,987,014 disbursed during the sample period. We also

reviewed the supporting documentation to determine whether the disbursements were adequately supported.

To determine the composition of the \$16.9 million balance in the account, we interviewed HPD's directors and officials from the Fiscal and Budget Department. We obtained and reviewed the 8A Section 17 account ledger from June 2009 through October 2010.

The results of the above tests, while not statistically projected to their respective populations, provide a reasonable basis for us to assess HPD's administration of the 8A Section 17 account in accordance with applicable rules and regulations.



MATHEW M. WAMBUA
Commissioner

Office of the Commissioner
100 Gold Street
New York, N.Y. 10038

December 19, 2011

Tina Kim
Deputy Comptroller for Audits
Office of the New York City Comptroller
1 Centre Street- Room 1100N
New York, New York 10007-2341

Re: Audit on HPD's Administration of its 8A Section 17 Bank Account
Audit Number: FM12-083A

Dear Deputy Comptroller Kim:

The following represents the Department of Housing Preservation and Development's response to the findings and recommendations made in your audit on the Housing Preservation and Development's Administration of its 8A Section 17 Bank Account. Thank you for your consideration during the fieldwork and at the Exit Conference.

If you have any additional questions, please call Assistant Commissioner Josh Cucchiaro at (212) 863-6610.

Thank you.

Sincerely,

Mathew M. Wambua

c: Elizabeth Weinstein, Director , Mayors Office of Operations
Douglas Apple
Joshua Cucchiaro



AUDIT RESPONSE
NEW YORK CITY COMPTROLLERS AUDIT
NEW YORK CITY DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT
ADMINISTRATION OF 8A SECTION 17 ACCOUNT
REPORT FM12-083A

Finding

Nearly \$17
Million
Improperly Held
in 8A Section 17
Account

Recommendation 1.

HPD should determine
the exact composition of
the account balance.

Response 1.

The Pool and Satellite account operates with a zero balance while the funds remain in the City's Treasury. HPD prepares monthly bank reconciliation statements and also submits the June's reconciliation (annually) to the Comptroller's Division of Accounting Compliance. In addition to reconciling monthly to internal records, HPD reconciles to the Central Pool Worksheet Balance report of the Department of Finance, Bureau of Treasury.

HPD has provided timely documentation to substantiate all deposits/disbursements questioned. HPD maintains records of bank reconciliations, checks, account ledger, and other supporting documentation to substantiate the transactions in this account. HPD will continue to work to determine the exact composition of the account balance.

Finding

Inadequate
Recordkeeping
Results in
Commingling of
Funds

Recommendation 2.

HPD should transfer and unrestrict the \$16.9 million, less any funds claimed by another funding source, from the 8A Section 17 account to the general fund/capital fund and return the funds to their appropriate budget codes in FMS. If needed, seek assistance from the Comptroller's Bureau of Accountancy for guidance on how to account for prior-year funds using FMS.

Response 2.

This account is currently used to temporarily hold unspent funds returned to the agency from previously issued construction loans. HPD is currently working with the Office of Management and Budget (OMB) to determine treatment of these funds. While these discussions are ongoing, HPD has opted to use the account to bring funds into the City's control, rather than leaving them at banks.

Once HPD and OMB make a determination on the treatment of these funds, HPD will transfer the said funds to the general fund/capital fund and appropriate Financial Management System (FMS) budget/revenue codes. Some funds are appropriate for immediate deposit, in which case HPD has taken them out of the account and allocated them appropriately. The balance on the Section 17 account is \$13.9 million as of December 2011, demonstrating our progress.

