

# Memorandum



CITY OF DALLAS

**DATE:** May 13, 2016

**TO:** Honorable Members of the Housing Committee –  
Scott Griggs (Chair); Carolyn King Arnold (Vice Chair);  
Mayor Pro Tem Monica R. Alonzo; Mark Clayton;  
Casey Thomas II; Tiffini A. Young

**SUBJECT:** Audit of the Department of Housing/Community Services' Contract Monitoring

I will provide a briefing to the members of the Housing Committee on Monday, May 16, 2016 regarding:

- Audit of the Department of Housing/Community Services' Contract Monitoring

Sincerely,

Craig D. Kinton  
City Auditor

C: Honorable Mayor and Members of the City Council  
A.C. Gonzalez, City Manager  
Christopher D. Bowers, Interim City Attorney  
Rosa A. Rios, City Secretary  
Jeanne Chipperfield, Chief Financial Officer  
Daniel F. Sofis, Administrative Judge  
Bernadette Mitchell, Director – Housing/Community Services  
Elsa Cantu, Assistant to the City Manager – Mayor & Council

Ryan S. Evans, First Assistant City Manager  
Eric D. Campbell, City Manager  
Jill A. Jordan, P.E., Assistant City Manager  
Mark McDaniel, Assistant City Manager  
Joey Zapata, Assistant City Manager  
Alan E. Sims, Chief of Neighborhood Plus  
Sana Syed, Public Information Officer

# Audit of the Department of Housing/Community Services' Contract Monitoring



**Housing Committee**

**City of Dallas**  
**Office of the City Auditor**  
**May 16, 2016**



# Audit Objective and Scope



## Objective

To evaluate whether the monitoring processes used for the affordable housing development projects are adequate to ensure compliance with contract terms and conditions



## Scope

Monitoring processes for affordable housing development projects

- Projects completed in Fiscal Years 2012 through FY 2014

# City Requirements

Administrative Directive 4-09, *Internal Control*, each department is required to establish and document a system of internal control procedures specific to its operations, mission, goals and objectives.

*The Standards for Internal Control in the Federal Government issued by the Comptroller General of the United States (Green Book):* established policies and procedures is a control activity needed to manage risk.

**Green Book:** documentation is required for the effective design, implementation, and operating effectiveness of an entity's internal control system.

**City Code Section 39C-11 (2)** requires that Department Directors “adequately document the transaction of government business and the policies, services, programs, functions, activities, and duties for which the department director and department staff are responsible.”



# Hierarchy of Internal Control Guidance City of Dallas



# Simple Definition of Internal Control

Internal control is what we do to see that the things we want to happen will happen . . .



And the things we don't want to happen won't happen. . . .



# Internal Controls are Common Sense

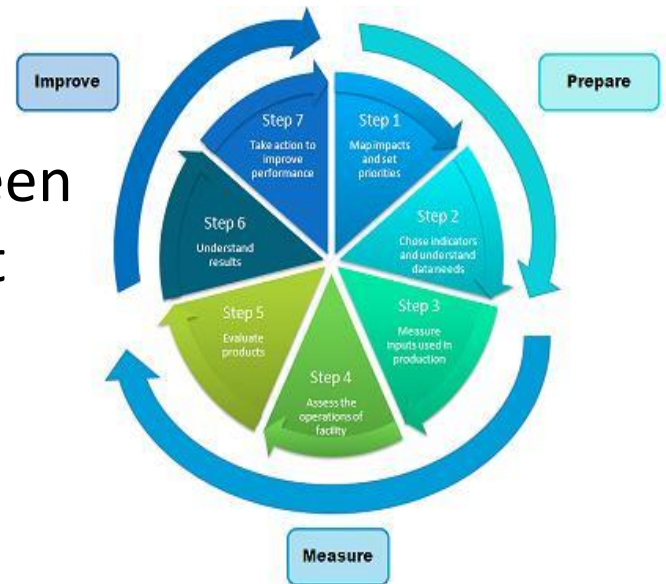


What do you worry about going wrong?

What steps have been taken to assure it doesn't?



How do you know things are under control?



# Definition of Internal Control

Internal Control is a process, effected by an entity's oversight body, management, and other personnel, that provides reasonable assurance that the objectives of an entity will be achieved. These objectives and related risks can be broadly classified into one or more of the following three categories:

- ▶ Operations – Effectiveness and efficiency of operations
- ▶ Reporting – Reliability of reporting for internal and external use
- ▶ Compliance – Compliance with applicable laws and regulations



# Relationship of Objectives and Components

Objectives



Components

Organizational Structure

# High Operational and Regulatory Risks for the Solicitation, Selection, Evaluation, and Underwriting



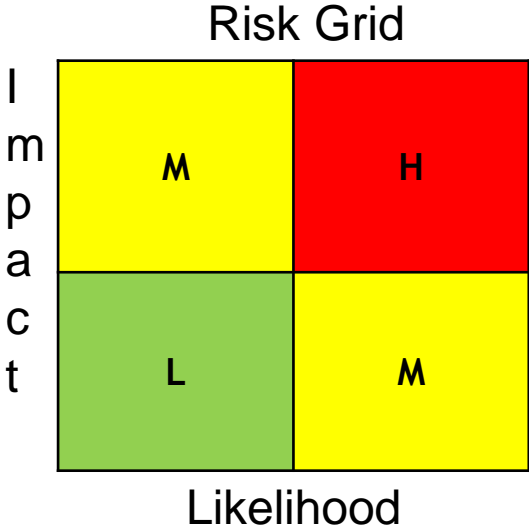
City selects an unqualified developer to perform the work



Loan Committee members are not qualified or selected improperly



Collusion or kickbacks between Loan Committee members and developers



# High Operational and Regulatory Risks for Compliance with Federal, State, and City Regulations



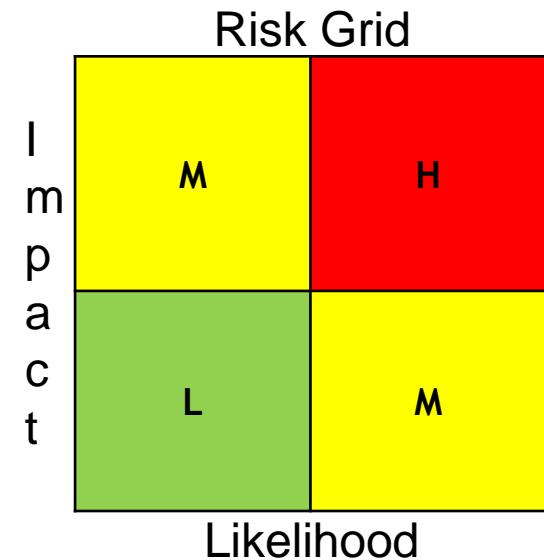
Contracts do not include all compliance requirements




Contracts do not include construction timelines, project standards, and reporting standards




Construction cost and quality do not meet contract terms




# High Operational and Regulatory Risks for Contract Monitoring



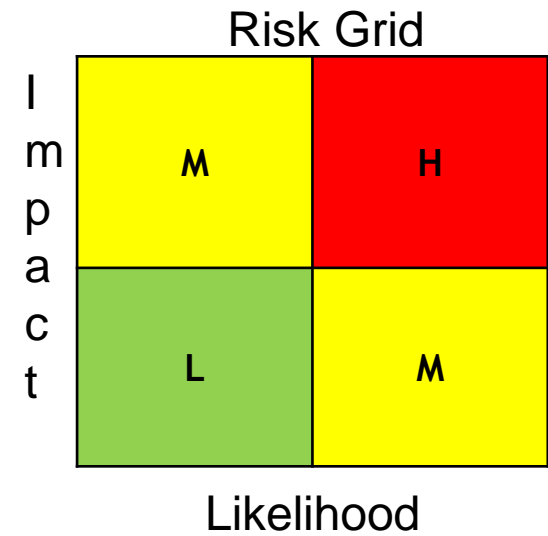
Monitoring is inconsistent



Monitoring does not ensure cost, quality, timeliness standards are met



Monitoring does not detect and document instances of non-compliance



# What did Auditors Do to Examine Monitoring Processes?



## Interviewed HOU staff

- Assistant Director
- Division Manager
- Project Coordinators
- Inspectors
- Other staff



## Requested, Obtained, and Reviewed

- Code of Federal Regulations Title 24
- City's Administrative Directives
- City Code
- HOU Policies and Procedures

# Best Practice Documents

- **State of Texas Contract Management Guide**
- **2015 Nebraska Affordable Housing Program Manual**

- **Components of an Effective Contract Monitoring System, Georgia State Auditor, July 2003.**
- **The Policy and Procedure Manual, Vermont Department of Human Resources.**

- **Writing Policies and Procedures, Co-pedia.**
- **Policy and Procedures Writing Guide, Boise State University**
- **Guide to Writing University Policy, Columbia University.**

- **2015 Multi-family Tax-Exempt Bond Programs Policies and Procedures. Texas State Affordable Housing Corporation**
- **2012 Fraud Examiners Manual. Contract and Procurement Fraud**

- **2016 Texas Department of Housing and Community Affairs Multifamily Direct Loan NOFA**
- **Developing an Economic Development Incentive Policy. Oct 2008. Government Finance Officers Association**

- **Financial Stability Board Sound Residential Mortgage Underwriting Practices. April 2012**
- **Risk Management Examination Manual for Credit Card Activities: Underwriting and Loan Approval Process.**

# Completed Projects Reviewed

Completed Projects Reviewed by Auditors	
Project Name	Amount Paid (AMS)
1. EDCO - NSP	\$ 141,174
2. EDCO Bexar Townhomes/Market	245,974
3. Garland Lots	63,000
4. FRI	1,025,000
5. Harding	16,070
6. Altura - NSP	1,101,809
7. Turner Courts	2,500,000
8. Heroes' House	550,000
9. Fair Park Estates	682,600
10. SCB - NSP	230,493
<b>TOTAL</b>	<b>\$ 6,556,120</b>

# FINDINGS

## HOU



**NO WRITTEN PROCEDURES**  
(inadequate and not relevant)



**DEPARTMENTAL PRACTICES ARE INADEQUATELY DOCUMENTED**

## Best Practices



**A LIST OF BEST PRACTICES IS PROVIDED AS EXHIBITS OR ATTACHMENTS IN THE AUDIT REPORT**



**A LIST OF DOCUMENTATION COMMONLY USED IN CONTRACT MONITORING IS INCLUDED AS AN EXHIBIT IN THE AUDIT REPORT**



# No Policies and Procedures for the Following Processes:

- ▶ Preparation and posting of the Notice of Funding Availability (NOFA)
- ▶ Evaluation (scoring) of the developers' responses to the NOFA
- ▶ Selection of the most beneficial Projects
- ▶ Underwriting
- ▶ Monitoring

## **A formal (written, approved, and dated) policy:**

- ▶ **Standards and policy objectives**
- ▶ **Comprehensive and specifies responsibility for action**
- ▶ **Framework for decision-making**
- ▶ **Guidance for handling programmatic issues**

**Formal (written, approved, and dated) procedures provide:**

- ▶ Directives and guidelines
- ▶ Detailed steps
- ▶ Supervisory and review roles
- ▶ Tasks, roles, and responsible parties
- ▶ Points of contact
- ▶ Decision points

# Elements of Adequate Policies and Procedures for the Evaluation and Selection of the most Beneficial Proposals

- ▶ Review/loan committee formation and member qualifications
- ▶ Minimum Requirements for each application:
  - Construction experience
  - Percent of affordable units
  - Aggregate exposure limit: for example, \$1 million to a single borrower
  - Maximum subsidy per unit
  - Minimum square footage per unit
  - Minimum quality of amenities, construction materials, and appliances

- ▶ Minimum Requirements for each application (*continued*):
  - Award priorities, preferences, and target needs
  - Scoring criteria and points system for meeting the minimum requirements and extra points for addressing target needs
  - Documented process for conducting applicant background checks
  - Definition of tie breakers
  - Required public hearings and meetings

# Elements of an Adequate Underwriting Policy and Procedure

- ▶ Evaluation of proposals against financial feasibility standards:
  - Loan to Value Ratio maximum
  - Sales and Income projections minimums
  - Debt Coverage Ratio minimum
  - Vacancy Rate minimum
  - Expense Ratio limit
  - Repayment sources availability
  - Reserve requirements for rental developments:
    - ❖ Escrows for taxes and insurance
    - ❖ Replacement reserves for new construction
    - ❖ Operating Reserves

# Elements of an Adequate Contract Monitoring Policy and Procedure

- ▶ Timeliness, cost, and quality standards
- ▶ Communication to developers of performance measures, standards, expectations, and deadlines
- ▶ Compliance with standards as a condition for reimbursement

# Elements of an Adequate Contract Monitoring Policy and Procedure

- ▶ Compare actual performance against the adopted standards, such as:
  - Post-award meetings
  - Off-site “desk” reviews of performance reports
  - Site visits
  - Inspections



# Elements of an Adequate Contract Monitoring Policy and Procedure

- ▶ Verification of the accuracy and reasonableness of construction expenses:
  - Actual expenditures vs. approved budget
  - Expenditures vs. completed work vs. the contract
  - Relevant documentary support
  - Invoices vs. contract progress
  - Withhold payment if no project progress

# Monitoring Documentation

- ▶ Meeting minutes
- ▶ Site visit reports
- ▶ Checklists of contract terms standards
- ▶ Compliance documentation
- ▶ Documentation of non-compliance
- ▶ Construction progress and quality inspection checklists
- ▶ Documentation of the methodology used to verify construction expenses
- ▶ Approvals and denials of developers' requests for reimbursement

# Recommendations

1. **Develop and implement formal (written, dated, and approved) policies and procedures** for the following processes:
  - Preparation and posting of the Notice of Funding Availability (NOFA) which is the solicitation to prospective developers for new single-family and multi-family affordable housing construction projects (Projects)
  - Evaluation (scoring) of the developers' responses to the NOFA
  - Selection of qualified developers who propose the most beneficial Projects
  - Underwriting the selected Projects
  - Monitoring the Projects



# Recommendations

## 2. **Develop, implement, and retain complete and consistent documentation** for the for the following processes:

- Preparation and posting of the Notice of Funding Availability (NOFA) which is the solicitation to prospective developers for new single-family and multi-family affordable housing construction projects (Projects)
- Evaluation (scoring) of the developers' responses to the NOFA
- Selection of qualified developers who propose the most beneficial Projects
- Underwriting the selected Projects
- Monitoring the Projects



# Response to Audit from Housing/Community Services

We agree with both recommendations:

- Collect sample formats for the structure of the policy and procedure documents and select one by September 30, 2016
- First written draft of internal controls policy by second quarter 2016-17
- Complete written policy by April 31, 2017
- Implement and begin testing internal controls and make revisions to the policy as needed
- Monitor and test the policy implementation going forward

Auditors would perform another audit in 2018.

# QUESTIONS?



**City of Dallas**  
**Office of the City Auditor**  
**May 16, 2016**

