



CITY OF SAN ANTONIO

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December 21, 2006

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Councilman, District 8

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City Manager

Ladies and Gentlemen:

SUBJECT: Limited Review of the San Antonio Development Agency's Funding Relationship between the City, SADA, and San Antonio Affordable Housing, Inc.

We are pleased to send you the report and Management responses for a limited review requested by Jelynn L. Burley, Deputy City Manager of the funding relationship between the City, San Antonio Development Agency (SADA), and San Antonio Affordable Housing, Inc.

SADA's Management and Staff should be commended for their cooperation and assistance during this limited review. The Corrective Action Plan indicates partial acceptance of the recommendation in our report. According to City Staff, this is mostly due to other undisclosed issues identified during the transition process, which took place after our limited review had been completed.

The Internal Audit Department appreciates the opportunity to have performed this review and is available to discuss this material with you individually at your convenience.

Respectfully submitted,

Mark S. Swann CPA, CIA, CISA
Interim City Auditor

cc: Leticia Vacek, City Clerk



CITY OF SAN ANTONIO
INTERNAL AUDIT DEPARTMENT

Limited Review of the San Antonio Development Agency

**Funding Relationship between the City, San Antonio
Development Agency, and San Antonio Affordable Housing, Inc.**

Project No. AU06-015

Issue Date: December 21, 2006

Mark Swann CPA, CIA, CISA
Denis Cano CPA, CIA, CISA
Christopher Williams, CGAP

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Executive Summary

Overview

A limited review of San Antonio Development Agency's (SADA) operations, as requested by the Deputy City Manager, has been completed. The objective of this project was to evaluate the appropriateness of the funding relationship between the City of San Antonio, SADA, and San Antonio Affordable Housing, Inc., as well as, assess SADA's compliance with applicable laws and regulations.

In 1958, the City created SADA as an urban renewal agency to revitalize slum and blighted areas in San Antonio, primarily the downtown area. Accordingly, SADA acquired property downtown in order to rehabilitate and/or construct affordable homes for sale to low and moderate income individuals. The City, to continue this initiative, contracts annually with SADA by providing Community Development Block Grant (CDBG) and HOME funds for this purpose.

Results In Brief

Historically, SADA Management has operated with minimal distinction between SADA and SAAH. This is evidenced by having SADA's Board of Directors, Executive Director, and Controller serve in the same capacity for SAAH. Although SADA and SAAH's mission is congruent with each other, financial records do not always reflect appropriate arms length transactions between the two organizations. SAAH's financial impact is considered by SADA during its final decision-making process.

It was noted that SADA has considerable financial issues associated with its operations, including a going concern. There is also significant compliance issues related to the City's CDBG contract. The following issues were observed during our limited review of SADA:

- Financial records do not reflect proper time and effort reporting for the CDBG grant. Also, costs are not allocated between SADA's CDBG grant, SAAH, and other operations, as required by the Office of Management and Budget (OMB) Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations".
- SADA did not report to the City approximately \$274,000 in program income from sale of land and a home, management fees, rental income, and interest income. This income was used to fund current operations without prior approval from the City.
- SADA guaranteed \$805,400 of bank notes and lines of credit in behalf of SAAH, which is in violation of the contract with the City. The amount currently outstanding is \$145,094, of which \$50,000 was due on October 13, 2006.

The report intentionally does not include recommendations for the issues described above since the City of San Antonio is de-funding SADA as of October 31, 2006 and re-evaluating its interest in SAAH, including the service it provides to the community. However, the Deputy City Manager should pursue collection of the amount currently owed by SAAH, which is approximately \$25,000, in addition to the management fee for the pending sale of the 122 Ardmore property.

INTRODUCTION

Background

Through City referendum, the City of San Antonio created in 1958 an urban renewal agency, known as the San Antonio Development Agency (SADA), to undertake urban redevelopment activities in slum and blighted areas.

This agency consists of ten positions and is governed by seven Board of Commissioners that are appointed by City Council. Its mission is to revitalize the inner city and selected target areas by making buildable lots available at a reasonable market rate to fulfill the revitalization plan initiated by the City.

To assist SADA with its urban renewal mission, SADA's Board of Commissioners established in 1995 a 501(c)(3) non-profit organization, known as San Antonio Affordable Housing, Inc. (SAAH). SAAH's mission, consistent with SADA's, is to foster community development through the preservation and development of affordable housing, offer affordable rental or home ownership opportunities to low and moderate income individuals, and cooperate in the development of infrastructure and businesses in low income areas of San Antonio.

Through cooperative efforts of the City and the U.S. Department of Housing and Urban Development (HUD), HUD has provided grant allocations from Community Development Block Grant (CDBG) and HOME Investment Partnership Programs to carry out various types of redevelopment projects in San Antonio.

Generally, these projects have been located downtown since certain areas have become derelict due to the emergence of suburban commercial locations. Families with economic means have left the downtown area for suburban life, leaving behind predominantly low income families to reside there.

Currently, SADA is involved in several neighborhood revitalization, restoration, and commercial/residential redevelopment projects in City Council designated neighborhoods, such as Historic Gardens, Highland Hills, and Fort Sam Houston Gateway on the east side.

SAAH, in collaboration with SADA, have bought properties primarily on the west side of San Antonio to rehabilitate or construct affordable homes for sale to low and moderate income individuals. In fiscal year 2006, SAAH constructed seven homes, six of which were sold at sales prices ranging from \$75,000 to \$99,000. The remaining home is currently in the process of being sold.

To continue with the City's endeavor of urban renewal activities in San Antonio, the City contracts annually with SADA by providing CDBG and HOME funds for this purpose. Specifically, City Ordinance 100914, dated May 19, 2005, funded \$552,802 of SADA's administrative costs for fiscal year 2006 through the Department of Housing and Community Development.

Criteria

This limited review compared SADA's program functions with applicable laws and regulations; with the San Antonio Development Agency - Administration Contract; with Departmental policies; with prior internal monitoring reports; and with audit reports by an external firm.

The Office of Management and Budget (OMB) Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations" was specifically utilized to evaluate the Federal grant program activities since OMB sets forth standards for organizations applying for, expending, and accounting for Federal and State grants.

Objectives and Scope

The objectives of the limited review were to determine the following:

- Evaluate the appropriateness of the funding relationship between the City, SADA, and SAAH
- Assess if SADA is in compliance with applicable laws and regulations, including Contract requirements

The scope of the review focused mainly on SADA and SAAH's financial transactions, and other activities, between October 2005 and September 2006.

Methodology

The methodology used for this project, generally, included the following:

- Gathering and reviewing information and documentation from the City, the Department of Housing and Community Development, San Antonio Affordable Housing, Inc., and other entities
- Conducting interviews with SADA's Management and Staff
- Performing and evaluating transactional and other test work of SADA and SAAH, including activity, revenue, and expenses
- Performing judgmental sampling techniques to select transactions for detailed testing

The limited review was designed to provide reasonable, but not absolute, assurance about SADA's performance. Although the review was based on discussions, interviews, tests of selected documentation, and site visits, the procedures used would not necessarily reveal all internal control weaknesses.

Risk Management Capability Matrix

A risk management capability was not performed due to the limited scope of this review.

Observations

This review provided evidence of significant control issues. The observations have been summarized for this report in two categories: financial issues and noncompliance with contract requirements.

1. Financial issues

1.1 SADA's going concern is uncertain

SADA does not have the necessary cash flow to meet payroll, loan obligations, and \$73,000 of outstanding attorney fees. According to the Controller, additional funds have been made available by the City to meet approximately \$19,000 in bi-weekly payroll cost since September 2006. Furthermore, loans have been extended due to SADA's inability to payoff the loans as they mature.

1.2 Questionable arms length transactions occurred between SADA and SAAH

A Memorandum of Understanding (MOU) between SADA and SAAH was signed on September 29, 2004 by the Executive Director. However, the validity of the MOU is questionable when the same individual signs in behalf of both entities.

The MOU is vague and does not include specific payment terms regarding the construction management and/or technical services provided by SADA. The MOU states that SADA's Executive Director is authorized to charge SAAH for services rendered based on a percentage of the sales price of the home. However, based on actual transactions, SADA has been paid 45% of net profit, not a percentage of the sales price of the home. According to the Controller, the basis for payment to SADA was changed due to their perceived inequity of the amount remaining for SAAH.

Also, in reviewing revenue transactions, it was noted that since 2003, SAAH has deposited in their bank account \$26,390 in rental income for a property (i.e., 1706 Socorro) owned by SADA. As of October 2006, SAAH still owes SADA over \$14,000 for amounts improperly collected. According to SADA's Controller, he did not realize that title to the property had not been transferred to SAAH, as it was intended at one point.

In addition, interest free loans of \$65,000 were identified in reviewing transactions between the two entities for fiscal year 2006. As referred by the Controller, SADA funded temporary advances of \$15,000 on February 7, 2006 and \$50,000 on March 23, 2006 to help SAAH with cash flow issues. It appears that the \$15,000 was used to cover construction costs pending a sale of a home and \$50,000 was used to pay off a maturing bank loan. SAAH repaid SADA the \$15,000 on February 2006 and the \$50,000 in two installments (i.e., \$25,000 in April 2006 and \$25,000 in June 2006).

1.3 Numerous accounting issues were noted

A limited review of SADA's accounting records was performed for fiscal year 2006. The following issues were identified:

- Management fees – A cost analysis was not performed to determine the appropriateness of the management fees received from SAAH. Although the majority of SADA's personnel invested over a 3-month effort in purchasing lots, overseeing construction, and/or selling homes, these fees only averaged approximately \$3,500 per home in fiscal year 2006. Furthermore, it was noted that SAAH owes SADA approximately \$6,300 due to miscalculated management fees for sale of the 350 Estrella and 2700 Wade properties.
- Returns and credits – Approximately \$10,000 in returns and credits, associated with material purchases for fiscal years 2005 and 2006, were not offset against home construction costs. Thus, the management fees paid to SADA was understated by approximately \$4,500 (i.e., 45% of net profit) since construction costs were overstated by \$10,000.
- Due to's / from's – The Due from SAAH beginning balance for October 1, 2005 was overstated by approximately \$25,000. It inappropriately included receivables from fiscal year 2004 that were paid off in fiscal year 2005.

- Fiscal year 2006 beginning balances - The fiscal year 2005 ending balances were not rolled-over as beginning balances for fiscal year 2006 until October 2006, over a year later. This makes it difficult for management to properly analyze accounts.
- Bank accounts - There are old bank accounts with balances relating to rehab home activities that were performed by SADA prior to its mission change in 2001. Although the Controller expected to turn over these funds to the City during fiscal year 2006, this has yet to occur. The following are the bank balances as of September 18, 2006:
 - \$306,415 – Revolving Loan Account
 - \$75,400 – Collateral Account (should be at \$100,000)
 - \$35,445 – Construction Escrow Account
 - \$4,168 – Escrow Account

2. Noncompliance with contract requirements

2.1 Time and effort reporting is not performed for the CDBG grant

SADA is federally funded by a pass-through CDBG grant. As such, OMB Circular A-133 requires proper time and effort reporting when employees perform duties for more than one program. However, it was noted that SADA’s payroll records do not reflect time spent on projects unrelated to the CDBG grant. According to SADA staff, employees are paid by the CDBG grant, regardless of the work performed by the employee.

2.2 Cost is not allocated between SADA’s CDBG grant and SAAH operations

OMB Circular A-133 requires proper cost allocation for federally funded programs. However, in discussion with the Controller, SADA pays overhead cost related to SAAH’s operations, including, payroll, supplies, insurance for homes under construction, mileage, use of equipment, etc. Furthermore, the accounting package used to maintain SADA’s records is also used for SAAH at no cost to the non-profit organization.

It was also noted that the Executive Director instructed the Construction Specialist II to develop cost estimates for construction of three homes and a commercial building, which were not consistent with SADA’s mission. These homes were approximately 2,552 to 3,200 square feet, as compared to the customary 1,300 square foot homes currently built for low and moderate income individuals in San Antonio. The following is a description of the four properties:

- 3,200 total square feet – proposed construction of a residence in Bulverde (outside of San Antonio)
- 2,552 total square feet – proposed construction of a residence in unknown location
- Square feet unknown – proposed construction of a residence at 219 Holland in Olmos Park (outside of San Antonio)
- Square feet unknown – proposed construction of a two story commercial property for a beauty salon on DeZavala Road

According to the Construction Specialist II, he is not aware whether any construction occurred at these sites.

2.3 Program income was used for current operations without prior City approval

According to the contract with the City, program income that is generated using CDBG funds should be reported and submitted to the City on a monthly basis. However, in fiscal year 2006, SADA received \$274,091 in program revenue that was used to fund regular operations without prior City approval. The following is a breakdown of the program revenue observed in fiscal year 2006.

<u>Amount</u>	<u>Description of Program Revenue</u>
\$213,299	Sale of land and a home in Greater Alamedome Urban Renewal Area
51,752	Management fees for services provided to SAAH and American Sunrise
7,716	Rental income - 1706 Socorro property
1,324	Checking account interest
<u>\$274,091</u>	Total

2.4 Inappropriate bidding practices were performed

On March 31, 2005, SADA's Planning/Project Development Manager engaged in correspondence with a bidder by soliciting a revised bid for a \$298,503 landscaping contract after the sealed bids had been received and evaluated, but prior to staff recommendation for Board of Commissioners approval.

Based on an interview with the employee, it was determined that other qualified bidders were not given the same opportunity to reconsider their bid prior to presentation of the results to SADA's Board of Commissioners.

Contract bidding practices that provide preferential treatment for individual contractors is not in-line with the City of San Antonio's contract bidding requirements nor OMB Circular A-133. It damages the reputation of SADA and the City as fair and impartial organizations.

2.5 SADA inappropriately guaranteed bank notes and lines of credit in behalf of SAAH

In fiscal year 2006, SADA guaranteed \$805,400 of bank notes and lines of credit in behalf of SAAH. As of September 30, 2006, the bank notes and lines of credit have an outstanding balance of \$145,094, of which, \$50,000 was due on October 13, 2006. According to the Controller, the bank note was to be extended due to SAAH's current inability to pay off the loan.

Risk / Recommendation

The report intentionally does not include risks and recommendations associated with the issues described above since the City of San Antonio is de-funding SADA as of October 31, 2006 and re-evaluating its interest in SAAH, including the service it provides to the community. However, the Deputy City Manager should formally communicate to SADA's Board of Commissioners the amount currently owed by SAAH, which is approximately \$25,000, in addition to the management fee for the pending sale of the 122 Ardmore property.



CITY OF SAN ANTONIO

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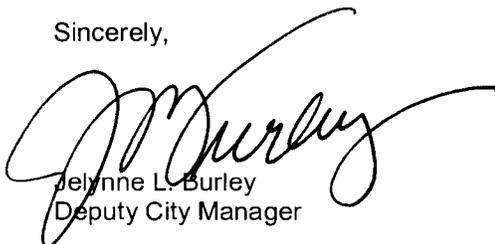
RE: Management's Corrective Action Plan for the Limited Review of the San Antonio Development Agency – Funding Relationship between the City, SADA, and San Antonio Affordable Housing, Inc.

City Management has studied the limited review report for the funding relationship between the City, SADA, and San Antonio Affordable Housing, Inc. and this is a Corrective Action Plan responding to the review's recommendation.

Recommendation					
#	Description	Audit Report Page	Accept, Partially Accept, Decline	Responsible Person's Name/Title	Completion Date
Detail Report					
1	Formally communicate to SADA's Board of Commissioners the amount currently owed by SAAH, which is approximately \$25,000, in addition to the management fee for the pending sale of the 122 Ardmore property.	6	Partially Accept	Raquel Favela Development Manager	March 30, 2007
	<p>Action plan: City Management has executed a Memorandum of Understanding (MOU) with the San Antonio Development Agency (SADA) which defines the legal relationship between COSA and SADA. This MOU allows city staff access to the SADA Board in order to complete due diligence to validate the findings outlined above as well as other findings discovered during the transition process. The SADA Board is still the governing body of the agency and as such must meet to review these findings and approve requests for payments from the SAAH. The City will work with the SADA Board to identify other assets and liabilities that may have an impact on this finding. The City is working to establish standing Board meetings to provide status reports and request consideration and direction on pending business items. The City has informed the SADA legal counsel, Escamilla & Poneck that the Limited Review Report and the findings outlined need to be placed on the next Board agenda. City staff will provide monthly updates to the Office of the City Auditor on this audit finding until resolution is reached.</p>				

We appreciate the City Auditor's comments on the funding relationship between the City, SADA, and San Antonio Affordable Housing, Inc. We are committed to addressing the recommendation in the limited review report and the plan of action presented.

Sincerely,



Jelynn L. Burley
Deputy City Manager