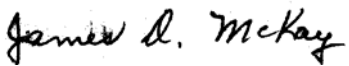




Issue Date
September 15, 2005

Audit Case Number
2005-AT-1013

TO: Jose R. Rivera, Director, Community Planning and Development, San Juan Field Office, 4ND

FROM: 
James D. McKay
Regional Inspector General for Audit, 4AGA

SUBJECT: Corporación para el Fomento Económico de la Ciudad Capital, San Juan, Puerto Rico, Did Not Administer Its Independent Capital Fund in Accordance with HUD Requirements

HIGHLIGHTS

What We Audited and Why

We completed an audit of the Corporación para el Fomento Económico de la Ciudad Capital (Corporation) independent capital fund. The review was initiated in response to a request from the Department of Housing and Urban Development's (HUD) San Juan Office of Community Planning and Development, which was not satisfied with the Corporation's overall performance in administering its independent capital fund. HUD's concerns stemmed from the results of a monitoring review conducted by the Municipality of San Juan (Municipality) and included concern over the Corporation's use of program income funds for ineligible purposes. The objective of our audit was to determine whether the Corporation administered the independent capital fund in accordance with HUD requirements.

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What We Found

The Corporation did not follow HUD requirements in the administration of its independent capital fund. Contrary to HUD requirements, the Corporation retained more than \$1.48 million in interest earned from its Community Development Block Grant (Block Grant) revolving fund account.

The Corporation's financial management system did not fully comply with applicable HUD requirements. The system did not properly identify the application of more than \$1 million in administrative fees charged, allowed the use of \$463,618 for ineligible expenditures, did not account for all program income, and maintained a high balance in its Block Grant fund account.

In four loans reviewed, the Corporation did not maintain adequate records to demonstrate that activities met at least one of the three Block Grant national objectives. Therefore, the related expenditures of four loans totaling \$631,195 are considered unsupported pending an eligibility determination by HUD.

What We Recommend

We recommend the director of the San Juan Office of Community Planning and Development require the Municipality to repay \$1.48 million in interest earned from the Block Grant revolving fund and repay \$463,618 in ineligible expenditures. The director should also require the Municipality to provide all supporting documentation and determine the appropriateness and eligibility of \$1.64 million in Block Grant disbursements. We also recommend that the director require the Municipality to develop and implement an internal control plan to ensure the independent capital fund has a financial management system that complies with HUD requirements and that funds are used in a timely manner.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directive issued because of the audit.

Auditee's Response

We discussed the findings with the Municipality and the Corporation during the audit and with the Municipality at the exit conference on August 11, 2005. The Municipality provided its written comments to our draft report on August 26, 2005. In its response, the Municipality generally agreed with the findings.

The complete text of the Municipality's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Municipality of San Juan (Municipality) implemented an economic development program that was carried out through its subgrantee, the Corporación para el Fomento Económico de la Ciudad Capital (Corporation). The Corporation, a nonprofit subgrantee, was incorporated in June 1982 and was established to promote economic development and housing activities within San Juan, Puerto Rico. Between 1983 and 1992, the Municipality assigned more than \$5.9 million in Community Development Block Grant (Block Grant) funds and delegated the administration of \$20.4 million in Urban Development Action Grant (Action Grant) loans to the Corporation. Proceeds from Block Grant and Action Grant funds were used to establish the independent capital fund, a revolving fund program to promote economic development loans. The Corporation used the proceeds from loan repayments to generate new economic development loans, and to pay for administrative expenditures of the program. The Municipality has not approved new funding to the Corporation since 1992.

The Municipality is responsible for monitoring the Corporation's performance and to ensure that all aspects of HUD funded activities are carried out in accordance with applicable laws and regulations. During 2002, the Municipality completed a monitoring review of the Corporation's independent capital fund. The Municipality concluded the Corporation did not comply with Department of Housing and Urban Development (HUD) requirements and decided to regain control over all assets associated with the independent capital fund. In April 2002, the Municipality notified the Corporation of its decision to discontinue approving the use of Block Grant funds. Therefore, the use of Block Grant funds for economic development loans was halted. No new loans have been approved since then.

In a letter, dated May 30, 2003, the Municipality requested the Corporation to transfer all assets associated with the independent capital fund to the Municipality. The Corporation did not agree with the Municipality's determination and retained control of the independent capital fund. As a result, the Municipality took the matter to federal court to regain control of the independent capital fund. The matter remains unresolved.

The objective of our audit was to determine whether the Corporation administered the independent capital fund in accordance with HUD requirements. The compliance requirements include the expenditure of HUD funds for eligible, necessary, and reasonable project costs, maintaining adequate financial controls over funded activities, and maintaining adequate documentation showing compliance with national objectives.

RESULTS OF AUDIT

Finding 1: The Corporation Did Not Remit HUD Interest Earned from Revolving Fund

The Corporation did not follow HUD requirements in the administration of its independent capital fund. Contrary to HUD requirements, the Corporation retained more than \$1.48 million in interest earned from its Block Grant revolving fund account. The deficiencies occurred because Corporation officials believed they were entitled to the earnings. In addition, the Municipality had not established and implemented adequate controls to ensure the Corporation complied with applicable requirements. Thus, the Corporation improperly retained and used monies belonging to the federal government to finance its operations.

Interest Earned on Revolving Fund

Our review disclosed the Block Grant revolving fund accounts generated more than \$1.48 million in interest income. For example, the Corporation placed more than \$2.31 million in eight certificates of deposit with a local financial institution between September 2001 and February 2003. As of April 2005, the certificates had accumulated at least \$341,756 in interest.

	Issue date	Maturity date	Interest rate	Certificate face value	Interest accrued
Certificate A	Sept. 11, 2001	Sept. 11, 2006	5.50%	\$ 300,000	\$ 65,193
Certificate B	Sept. 11, 2001	Sept. 11, 2006	5.50%	300,000	65,193
Certificate C	Aug. 20, 2002	Aug. 20, 2007	4.75%	316,922	42,735
Certificate D	Aug. 20, 2002	Aug. 20, 2007	4.75%	316,922	42,735
Certificate E	Aug. 20, 2002	Aug. 20, 2007	4.75%	264,102	35,613
Certificate F	Aug. 20, 2002	Aug. 20, 2007	4.75%	316,922	42,735
Certificate G	Feb. 25, 2003	Feb. 25, 2008	4.25%	250,000	23,776
Certificate H	Feb. 25, 2003	Feb. 25, 2008	4.25%	250,000	23,776
Total				\$2,314,868	\$ 341,756

The Corporation also placed additional monies from the Block Grant revolving fund in certificates of deposit that generated a substantial amount of interest income in prior years. According to Corporation records, the income generated from these additional certificates exceeded \$1 million.

Fiscal year	Interest earned
1995-1996	\$107,787
1996-1997	\$149,128
1997-1998	\$179,702
1998-1999	\$185,646
1999-2000	\$230,241
2000-2001	\$190,977
Total	\$1,043,481

Corporation officials informed us that it has been their policy to invest funds and use the income generated to finance their operations. None of the interest earned from the revolving fund accounts was remitted to HUD or the Municipality because the Corporation believed it was entitled to the earnings. This policy is in violation of HUD requirements contained in 24 CFR [*Code of Federal Regulations*] 570.500(b). Grantees and subgrantees are required to remit interest earned on revolving fund accounts to HUD for transmittal to the U.S. Department of the Treasury.

The Block Grant revolving fund earned an additional \$96,497 from its checking account and other investments. Therefore, the Block Grant revolving fund account generated at least \$1.48 million that was not remitted to HUD for transmittal to the U.S. Department of the Treasury. The Municipality raised concern about this practice in the March 2002 monitoring review. In September 2003, the San Juan Office of Community Planning and Development informed the Municipality that any interest earned on the revolving fund accounts must be returned to the U.S. Department of the Treasury.

Recommendations

We recommend the director of the San Juan Office of Community Planning and Development

- 1A. Require the Municipality to remit to HUD from nonfederal funds \$1,481,734 in interest earned on Block Grant revolving fund accounts improperly retained by the Corporation.
- 1B. Take appropriate monitoring measures to ensure the Municipality remits future interest earned on revolving fund accounts to HUD in a timely manner for transmittal to the U.S. Department of the Treasury.

Finding 2: The Corporation’s Financial Management System Did Not Fully Comply with HUD Requirements

The Corporation’s financial management system did not fully comply with applicable HUD requirements. The system did not properly identify the application of more than \$1 million in administrative fees charged, allowed the use of \$463,618 for ineligible expenditures, did not account for all program income, and maintained a high balance in its Block Grant fund account. Consequently, the Corporation’s internal controls were not sufficient to safeguard assets or assure their use for authorized purposes and in accordance with HUD requirements. This occurred because the Corporation did not develop and implement policies and procedures to ensure compliance with financial requirements of HUD programs.

Unsupported Administrative Fees

The Block Grant program allows disbursements for reasonable expenditures associated with the planning and execution of community development activities provided these are supported by source documentation. Our review disclosed the Corporation charged the Block Grant revolving fund more than \$1 million in administrative fees between July 1997 and April 2005.

Fiscal Year	Fees charged	Approved Block Grant loans
1997-1998	\$ 131,540	0
1998-1999	137,311	0
1999-2000	127,228	0
2000-2001	58,236	13
2001-2002	141,754	10
2002-2003	191,740	0
2003-2004	125,024	0
2004-2005	98,968	0
Total	\$1,011,801	23

Corporation officials could not provide us documentation to support the \$1 million in administrative expenses. A Corporation official explained the administrative fees charged correspond to 20 percent of loan repayments received that were periodically transferred to the Corporation’s administrative account and used for administrative expenses of the Corporation. The official added that the administrative fees transferred could not be associated with a specific expenditure or invoice. Therefore, the accounting records do not reflect accurate, current, and complete disclosure of program expenditures. HUD has no assurance of the reasonableness, allowability, and allocability of the expenditures.

Unrelated Program Disbursements

We found the Corporation used more than \$449,000 in Block Grant monies for expenditures not related to the independent capital fund. The funds were used to meet requirements imposed by the Small Business Administration in the implementation of its micro-loan program. This included \$423,440 to cover loan loss reserves and \$25,773 in matching funds for loans awarded outside the city of San Juan. The Corporation had reimbursed some costs, and its accounting records reflected a remaining account receivable from the Corporation for \$393,104 as of February 2005.

The Corporation's accounting records reflected another account receivable from the micro-loan program for \$70,514. Corporation officials informed us the account receivable was also associated with the matching requirements imposed by the Small Business Administration and that corresponding support would be provided for our review. However, no support was provided showing the nature of the receivable.

The Block Grant program only allows disbursements for reasonable expenditures associated with the planning and execution of community development activities provided these are supported by source documentation.

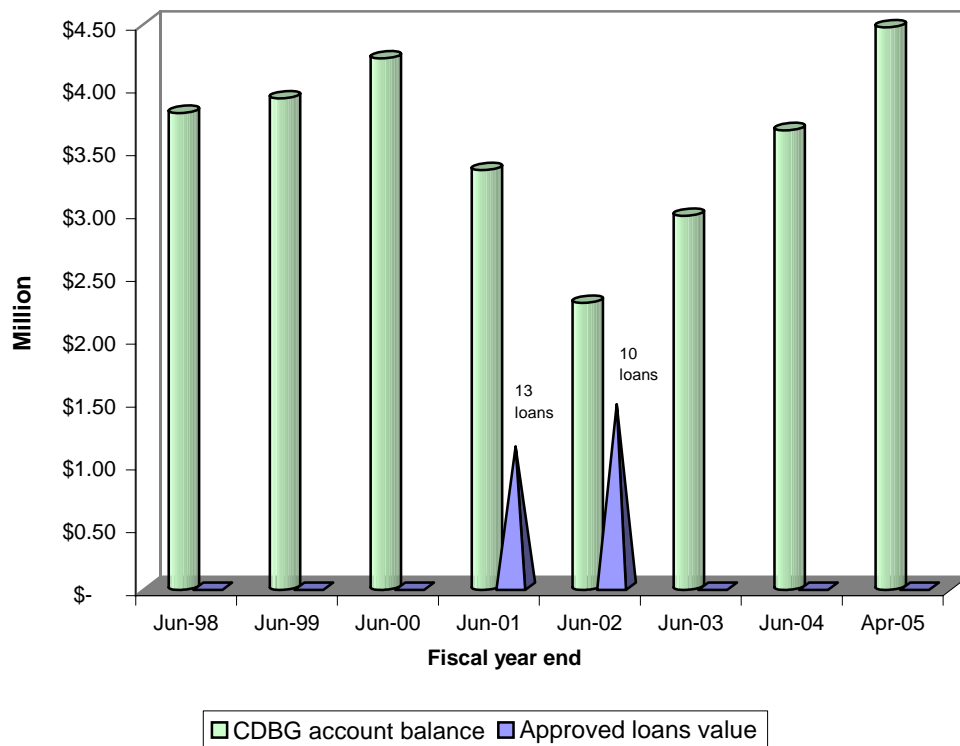
Program Income Not Recorded

HUD requires that receipt and expenditures of program income shall be recorded as part of the financial transactions of the grant program and are subject to all applicable requirements governing the use of Block Grant funds. Our review found the Corporation charged late fees to participants that did not repay loans in a timely manner. However, the Corporation did not record the late fees as part of the financial transactions of the independent capital fund. Instead, it has been the Corporation's practice to use late fee proceeds to finance its operations. Therefore, the Corporation cannot ensure that program income generated was used in accordance with HUD requirements. The Corporation's records showed that between July 1999 and April 2005, the proceeds from late fees amounted to \$60,016.

High Block Grant Fund Balance

The Corporation was passive in its use of Block Grant funds, allowing the accumulation of a significant amount of cash in the revolving fund accounts. As a result, funds were not used in a timely manner, diminishing the objectives and accomplishments of the Block Grant program. Our review found that between July 1997 and April 2005, the Corporation only approved 23 loans. However, the balance of the Block Grant revolving fund accounts remained consistently high during the same period. The Block Grant revolving fund maintained a year-end average balance of \$3.58 million.

Block Grant account balance and loans awarded



A Corporation official attributed the slow progress or use of the Block Grant funds to the Municipality's advice. The official explained that a former consultant of the Municipality recommended that the Corporation use Action Grant funds instead of Block Grant funds to award loans because there were fewer program restrictions. Therefore, the Corporation awarded loans only using Action Grant funds until the monies were almost depleted. This was not an acceptable explanation for not performing an integral component of its Block Grant loan program responsibilities. Also, the Corporation improperly invested the unused funds and retained the interest proceeds to finance its operations (see

finding 1). Further, the related benefits to low- and moderate-income persons were unduly delayed or not realized for more than three years, when no Block Grant loans were awarded.

In April 2002, the Municipality notified the Corporation of its decision to discontinue approving the release of Block Grant funds.¹ Therefore, the use of Block Grant funds for economic development loans was halted. No new loans have been approved since then. As a result, the balance of the Block Grant revolving fund continued to increase. As of April 2005, the revolving fund balance exceeded \$4.47 million, but the funds are not being used for their intended purpose.

Recommendations

We recommend the director of the San Juan Office of Community Planning and Development

- 2A. Require the Municipality to obtain and submit all supporting documentation and HUD determine the eligibility and propriety of \$1,011,801 in administrative costs the Corporation charged to the Block Grant revolving fund. Any amounts determined ineligible must be reimbursed to the Block Grant program from nonfederal funds.
- 2B. Require the Municipality to reimburse the Block Grant program from nonfederal funds \$463,618 for ineligible expenditures pertaining to the Corporation's Small Business Administration micro-loan program.
- 2C. Take appropriate monitoring measures to ensure the Block Grant revolving fund has in place a financial management system that complies with HUD requirements and the Municipality develops and implements a control plan so that Block Grant funds of \$4,099,501 are put to better use.² At a minimum, the system should ensure that fiscal controls and accounting procedures are sufficient to permit the tracing of funds, including program income, to a level that ensures such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

¹ This action was as a result of the March 2002 monitoring review performed by the Municipality that found deficiencies in the administration of the Block Grant revolving loan fund.

² The revolving fund balance of \$4.47 million was adjusted to consider interest income disallowed in finding 1.

Finding 3: The Corporation Did Not Demonstrate Compliance with National Objectives

In four loans reviewed, the Corporation did not maintain adequate records to demonstrate that activities met at least one of the three Block Grant national objectives. This occurred because the Corporation had inadequate management controls and was not familiar with applicable Block Grant regulations. Therefore, the related expenditures of four loans totaling \$631,195 are considered unsupported pending an eligibility determination by HUD.

Inadequate Documents

Our examination of 4 out of 11 outstanding Block Grant loans disclosed the Corporation did not take steps to ensure they met at least one of the three Block Grant national objectives required by 24 CFR [*Code of Federal Regulations*] 570.200(a).³ Grantees and subgrantees must carry out activities that benefit low- and moderate-income persons, aid in the prevention or elimination of slum and blight, or meet community development needs having a particular urgency.

Corporation officials informed us the majority of the loans approved met the national objective of benefiting low- and moderate-income persons based on the creation of jobs. Further, some loans may address other national objectives, such as the prevention or elimination of slum and blight. Although Corporation officials stated they properly evaluated each loan to ensure compliance with HUD’s national objectives, we did not find adequate support in the four loan files.

Loan number	Loan closing date	Number of low/medium-income jobs to be created per agreement	Loan amount
9-0099-01	Nov. 16, 2001	5	\$ 185,000
9-0102-01	Jan. 4, 2002	5	180,000
9-0089-01	July 24, 2001	5	161,195
9-0088-01	Dec. 6, 2000	3	105,000
Total			\$ 631,195

Specific examples of poor efforts to support national objectives compliance include

- ❑ **Benefit to low- and moderate-income persons job creation.** In all four loans, the Corporation executed written agreements with loan recipients,

³ The Corporation approved 23 Block Grant loans during fiscal years 2001 and 2002. Eleven of the loans were outstanding as of May 2005. These eleven loans had a total value of \$1,060,695.

which specified the number of permanent jobs to be created for low-and moderate-income persons. However, the Corporation did not

- Maintain documentation showing the income limits applied,
 - Maintain documentation showing the size and annual income of the person's family before the low- or moderate-income person was hired for the job, or
 - Ensure the written agreement with the loan recipient included a listing by job title of the permanent jobs to be created.
- **Prevention or elimination of slum and blight.** In January 2005, the Corporation certified that loan number 9-0102-01 was an eligible activity and that it met the national objective of preventing or eliminating slum and blight because of its location on Ponce de Leon Avenue. However, the loan file did not contain a description of the conditions that qualified the activity as one to aid in the prevention or elimination of slum or blight. Further, the Corporation did not provide information showing the activity was in an area that met a definition of a slum, blighted, deteriorated, or deteriorating area under state or local law.

The file deficiencies demonstrate the Corporation lacked adequate management controls and unfamiliarity with Block Grant regulations. Therefore, the intended benefits of the four loans and compliance with the Block Grant national objectives were not supported.

Recommendations

We recommend the director of the San Juan Office of Community Planning and Development

- 3A. Require the Municipality to obtain and submit all supporting documentation and HUD determine the eligibility and compliance with national objectives of the \$631,195 the Corporation disbursed for the four loans. Any amounts determined ineligible must be reimbursed to the Block Grant program from nonfederal funds.
- 3B. Take appropriate monitoring measures and require the Municipality to establish and implement policies and procedures to ensure future loans meet a Block Grant national objective.

SCOPE AND METHODOLOGY

Our audit objective was to determine whether the Corporation administered the independent capital fund in accordance with HUD requirements. To accomplish our objectives, we

- ❑ Obtained and reviewed relevant HUD regulations and Corporation guidelines.
- ❑ Interviewed HUD, Municipality, and Corporation officials and reviewed monitoring reports.
- ❑ Reviewed the Corporation's files and records, including financial statements, and general ledgers.
- ❑ Reviewed a sample of four Block Grant loan files.
- ❑ Reviewed the Corporation's controls related to the administration of its independent capital fund.

We obtained a list of Block Grant loans the Corporation awarded during fiscal years 2001 and 2002. The Corporation awarded 23 loans, of which 11 totaling \$1.06 million were outstanding as of May 2005. We selected and reviewed a sample of four outstanding Block Grant loans totaling \$631,195. The loans reviewed were those approved by the Corporation with a value greater than \$100,000. We reviewed each loan file to determine whether the activity met one of the three national objectives of the Block Grant program.

To achieve our audit objectives, we relied in part on computer-processes data contained in the Corporation's database. Although we did not perform a detailed assessment of the reliability of the data, we did perform a minimal level of testing and found it to be adequate for our purposes.

The audit generally covered the period of July 2003 through March 2005, and we extended the period as needed to accomplish our objectives. Due to the nature of some of the deficiencies, we extended the period back to July 1995. We conducted our fieldwork from March through June 2005 at the Corporation's offices in San Juan, Puerto Rico.

We conducted the audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Compliance with laws, regulations, policies, and procedures that management has implemented to reasonably assure that resource use is consistent with laws and regulations.
- Policies and procedures that management has implemented to reasonably assure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The Corporation did not remit to HUD more than \$1.48 million on interest earned from the Block Grant revolving fund (see finding 1).
- The Corporation's financial management system did not fully comply with HUD requirements (see finding 2).
- The Corporation did not demonstrate loans complied with national objectives of the Block Grant program (see finding 3).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

<u>Recommendation number</u>	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	<u>Funds to be put to better use 3/</u>
1A	\$1,481,734		
2A		\$1,011,801	
2B	463,618		
2C			\$4,099,501
3A		631,195	
Total	<u>\$1,945,352</u>	<u>\$1,642,996</u>	<u>\$4,099,501</u>


- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B


AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



CAPITAL CITY OF
SAN JUAN



*"Toward the San Juan
We Dream Of"*

*Comunidades of
Puerto Rico*

Jorge A. Santini-Padilla
Mayor

VIA E-MAIL & CERTIFIED MAIL

August 26, 2005

Mr. James D. McKay
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit, Region 4
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

RE: Municipality of San Juan's Comments to the *Corporación para el Fomento Económico de la Ciudad Capital* ("COFECC") Draft Audit Report

Dear Mr. McKay:

We appreciate the opportunity to comment on the findings of your draft audit report on COFECC (the "Report"). Although we generally agree with all your findings, we are concerned about the conclusions the Report draws out from the facts.

These are our comments:

Finding 1: The Corporation Did Not Remit HUD Interest Earned from Revolving Fund

The Report points out the following facts:

1. COFECC invested CDBG funds in financial instruments.
2. The investments produced interest income.
3. COFECC used the interests earned on the instruments to finance its operations.

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Comment 1

Mr. James D. McKay

August 26, 2005

4. COFECC was informed in 2002 by the Municipality that such practice violated the law.
5. HUD confirmed to the Municipality in writing that the interest earned from revolving funds investment had to be returned to the U.S. Treasury.
6. As of this date the monies are still retained by COFECC.

Notwithstanding these facts, the Report surprisingly concludes that the “deficiencies occurred because Corporation officials believed they were entitled to the earnings.” We feel that this conclusion is unsupported for the following reasons:

1. COFECC has a legal obligation under the Trust Agreement and under the annual award agreements to comply with CDBG and UDAG applicable regulations.
2. COFECC always had available the services of competent attorneys and consultants, and technical assistance from the Municipality.
3. The regulations are unambiguous over the illegality of using funds for investments, nullifying its public purposes.
4. Federal law is clear in establishing that interests on investments are not program income and must be remitted to the Treasury.
5. COFECC was informed twice by the Municipality of San Juan of the illegality of this practice and of its duty to remit the funds, in 2002 and again in 2003.

The Report does not sustain the finding of a “deficiency” caused by an incorrect belief. What the findings show is willful disregard of the regulations and the regulatory agencies involved. Additionally, the irregularities are not mere deficiencies, but major and substantial deviations from the law and the subrecipient agreements tantamount to a material breach of the subrecipient obligations.

Finding 2: The Corporation’s Financial Management System Did Not Comply with HUD Requirements

The second finding comprises several facts, to wit:

1. The accounting and managerial system of COFECC is not designed to meet CDBG requirements.

2

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2. COFECC charged unexplained administrative fees to CDBG.
3. CDBG funds “were used to meet requirements imposed by the Small Business Administration in the implementation of its micro-loan program.”
4. COFECC used program income to finance its operations.
5. OFECC used the Trust Fund as its own investment fund.

Comment 2

Once again, the facts do not support the picture of an ill oriented organization. When the facts are viewed as a whole, what arises is an organization that does not function and is not organized to function as a CDBG subrecipient but as a Certified Development Company under the Small Business Administration Act, providing loans pursuant to Section 504 and guarantees under Section 7, and micro loans. CDBG national objectives and purposes were alien to them. Furthermore, COFECC’s limited CDBG portfolio is comprised of low risk loans to capable entities, what makes us wonder if COFECC has incurred in creaming (that is, taking care of the richest of the poor, taking the fewest risks possible with community development dollars) since 1995. In this picture, CDBG funds were used to advance other objectives than those of the Program.

Finding 3: The Corporation Did Not Demonstrate Compliance with National Objectives

This finding is the natural consequence of what we have already alleged regarding COFECC’s real organizational goals.

Comment 3

COFECC “did not maintain adequate records to demonstrate that activities met at least one of the three Block Grant national objectives” and “had inadequate management controls and was not familiar with applicable Block Grant regulations” because CDBG was not in their minds. COFECC is not a newcomer subrecipient; it has managed federal funds and the Trust Fund for nearly two decades. Management has changed smoothly through the years. It is utterly improbable that they were in need of help and technical assistance from the Municipality. Indeed they had their own consultants. But COFECC moved through the years from a community based non profit organization to a financial entity, and their track shows how the low and moderate income

Comment 4

Mr. James D. McKay

August 26, 2005

population was exchanged for the small entrepreneur. SBA philosophy superseded CDBG objectives.

The Report lists the findings as each one independent of the others and as ancillary violations as opposed to material non compliance with CDBG regulations and the award agreements. The findings are analyzed disregarding the undeniable fact, attested by the facts in the Report, that the Municipality performed a monitoring of the corporation in 2002 and that its findings are the same as those listed in the Report, that corrective measures were requested at that time by the Municipality of San Juan, and that COFECC contemptuously resisted the Municipality's attempts to enforce them.

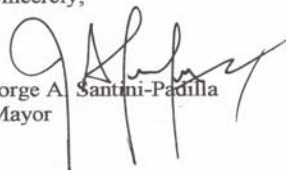
In addition to the findings included in the Report, there are other violations to federal regulation incurred by COFECC. Specifically, we want to point out the following:

- Violation to procurement regulations
- Multiple instances of violation of the conflict of interest regulations
- Lack of underwriting analysis in violation of 24 CFR 570.203(b).

These findings demonstrate COFECC's disregard for the applicable federal regulations and the required relationship among the Awarding Agency, Grantee and Subgrantee.

We respectfully believe that the Report was so focused on the trees that it failed to see the forest. Should you have any questions or concerns, please contact me or María Muñoz, Esq., at (787) 725-4864 or at mmunoz01@sanjuancapital.com.

Sincerely,


Jorge A. Santini-Padilla
Mayor

c: Michael A. Rivera
Assistant Regional Inspector General for Audit

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OIG Evaluation of Auditee Comments

Comment 1

We agree with the Municipality on the seriousness and magnitude of the deficiency and that remedial action is required. However, the cited violation was not of a recent origin. Further, we are not aware the Municipality made attempts to prevent or remedy the situation prior to the 2002 monitoring review. We attribute the deficiency to the inadequate controls of the Municipality and the Corporation's incorrect belief that they could retain the interest. The Municipality is ultimately responsible for the actions and accomplishments of its subgrantee, and must ensure that HUD requirements are followed at all times. Therefore, the Municipality must reimburse HUD the interest improperly retained by the Corporation.

Comment 2

Our objective was to determine if the Corporation's financial management system provides a complete disclosure of Block Grant receipts and expenditures as required by HUD. We found the financial management system for the Block Grant fund needs to be improved.

Comment 3

We are not suggesting that the Corporation is a new subgrantee or it has not been exposed to federal programs. Our conclusion and statements were based on the documents and responses we obtained from the Corporation's staff responsible for the review and/or monitoring of Block Grant activities.

Comment 4

We acknowledge the efforts taken by the Municipality during its 2002 monitoring review. However, the deficiencies included in the report are attributed to the inadequate controls of the Municipality and the Corporation. The Municipality is the direct recipient of Block Grant funds and must ensure that all the funds are used in accordance with applicable requirements. This includes Block Grant activities undertaken by its subgrantee. We are not suggesting that violations included in the audit report are all inclusive. We recommend discussing with HUD any other concerns the Municipality might have that were not addressed in the audit report.

APPENDIX C

CRITERIA

24 CFR [Code of Federal Regulations] 84.21

Standards for financial management systems require recipients' financial management systems to provide for the following:

- ❑ Records that identify adequately the source and application of funds for federally sponsored activities. These records shall contain information pertaining to federal awards, authorizations, obligations, unobligated balances, assets, outlays, income, and interest.
- ❑ Effective control over and accountability for all funds, property, and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.
- ❑ Accounting records, including cost accounting records, that are supported by source documentation.

24 CFR [Code of Federal Regulations] 570.200 (a) (2)

Each recipient under the Entitlement and HUD-administered Small Cities programs must ensure and maintain evidence that each of its activities assisted with Block Grant funds meets one of the three national objectives as contained in its certification.

24 CFR [Code of Federal Regulations] 570.500 (b)

Each revolving loan fund's cash balance must be held in an interest-bearing account, and any interest paid on Block Grant funds held in this account shall be considered interest earned on grant advances and must be remitted to HUD for transmittal to the U.S. Department of the Treasury no less frequently than annually.

24 CFR [Code of Federal Regulations] 570.504 (a)

The receipt and expenditure of program income as defined in § 570.500(a) shall be recorded as part of the financial transactions of the grant program.

24 CFR [Code of Federal Regulations] 570.506 (b)

This subpart provides minimum records the recipient shall establish and maintain to demonstrate that each Block Grant-assisted activity complies with one or more of the national objectives.