City of Greensboro

Date: April 5, 2004

To: Ed Kitchen, City Manager

From: Internal Audit

Subject: Project Homestead Audit Responses

We have reviewed the responses from the Board of Directors of Project Homestead, Incorporated (PHI) to the City audit performed on Program Income for the years 1997-2001. We are disappointed with PHI's response, as we had anticipated a more candid and explanatory report. The majority of the Board's responses do not address the issues and/or audit findings.

It is our overall opinion that the Board of Directors did not exercise its fiduciary responsibility and board oversight to ensure that the assets of the non-profit were maximized or that the appropriate policies and internal controls were in place to protect those assets. The CHDO Agreement executed between the City of Greensboro and Project Homestead required the agency to maintain records and documentation, to be in compliance with pertinent policies and HUD regulations, to be prepared for monitoring/audit visits and to demonstrate how any program income (CHDO proceeds) generated was used in the organization. The amount of program income could not be determined with certainty because of the commingling of funds. Further, responses received from the Board do not provide any explanations or more information/documentation.

Per your direction, based upon the issues mentioned above and prudent business practices, we have implemented a Zero Tolerance Policy. Additional policies, such as a requirement for boards of non-profits to attend classes/workshops with emphasis upon fiduciary responsibilities, and a requirement that management letters from external auditors who are associated with the external audit be submitted to the City of Greensboro, are just a few of the recommendations that staff has proposed as we move forward.

Based upon our review of the responses from Project Homestead's Board, we recommend that this agency not be funded in the future until it can be clearly demonstrated that the appropriate Internal Control Mechanisms, Policies and Procedures and Board Oversight provisions are in place and that we have obtained an Unqualified Opinion from Project Homestead's External Auditors with no concerns in the Management Letter. We also recommend that the City of Greensboro exhaust all remedies available to recover any funds that may be due to the City. If there are any questions or comments concerning the details of this review, we can be reached at 373-2821.

Len Lucas
Acting Internal Audit Director

Cc: Mitchell Johnson, Deputy City Manager
Ben Brown, Assistant City Manager for Economic Development
Bob Morgan Assistant City Manager
Linda Miles, City Attorney
Andy Scott, Director of Housing & Community Development
Dr. Alton Thompson, Chairman of Board of Directors of Project Homestead, Incorporated

City of Greensboro, North Carolina 27402

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Response to Program Income Audit: Project Homestead, Inc.

Introduction

The Board of Directors and Management of Project Homestead, Inc received the compliance audit on Program Income and Project Proceeds generated by the use of federal, state and local funding from the City of Greensboro for the years 1997-2001. We would like to commend Mr. Len Lucas, Acting Internal Audit Director, for the professional and courteous manner in which he and the external auditors conducted this audit. We also would like to thank the interim staff for their diligent efforts to assist the auditors in finding the requested documents and inventory items.

As the board reviewed the City's audit, we were reminded of the tremendous assets that Project Homestead has contributed to the City of Greensboro and Guilford County. Project Homestead was responsible for the development of more than 700 homes in the City of Greensboro, and an estimated $70 - $80 million of economic and business development. Project Homestead was recognized as the third largest homebuilder in Guilford County, and was easily the largest builder in the affordable housing market.

There have been numerous references made in the media to the $17, 600,734 that was awarded to Project Homestead by the City of Greensboro between 1991 and June 30, 2003. However this audit focuses specifically on the $5,785,000 that was awarded to Project Homestead by the City between 1997 and 2001 and therefore the board is responding to dollars awarded to PH during the timeframe covered by the audit. During the audit period, PHI's revenue was $50,907,000; therefore, City grants or allocation during this period was 11.4 percent of the agency's budget.

Although the funds were kept in one account, all of the City's grants or allocations are accounted for as illustrated in the chart below:

Project Name	**Use of Funds**	**City of Greensboro**
Funds that flowed through Project Homestead		
CHDO	Operating Support	$60,535
New Garden Academy	Homeowner Preparation	$31,650
Homeownership	Counseling	$207,281
Homeless Prevention	Temporary Housing and Support	$119,765
Subtotal		**$419,231**

Funds that did <u>NOT</u> flow through Project Homestead		
640 MLK Drive	Rehab PH office	$327,490
	Sale/lease Purchase	$105,100
Economic Development	Cumberland Shopping Center Job Training Center	$831,019
Multi-Family Construction	New Garden Place (76 units) Alexander Homes (40 units) R.S. King Apartments (40 units) Coley Jenkins (40 units) Kingsgate South (36 units) Seager Place (42 units) L. Richardson Hospital (24 units) Richardson Village (24 units) Sebastian House Resource Center	$5,604,716
Single-Family Second Mortgages Donated Lots	Harvest Hills (22 lots and second mortgages) Brooke Gardens, I (27 lots and second mortgages) Brooke Gardens, II (10 lots and second mortgages) Brooke Gardens, III (11 lots) Abington Place (16 lots and second mortgages) Turning Point (129 lots and 45 second mortgages) Kings Landing (50 lots)	$10,313,178
Subtotal		**$17,181,503**
Total		**$17,600,734**

These funds were audited by the City of Greensboro Audit Department as the grants were disbursed. The construction projects were also subject to the City's Engineering Department's approval prior to the City providing payment to Project Homestead.

Much of the funding went directly to individuals and was not received directly by Project Homestead, Inc. In addition, both Project Homestead and City of Greensboro's records indicate that, over this twelve year period, Project Homestead only received grants from the City of $419,231 for operations. Of this $419,231, $69,765 was distributed directly to program participants, and were audited by the City. These funds represented less than three percent of the $17,600,734 and less than one-half of one percent of Project Homestead's operating budget. Of the remaining funds, $16,462,103 were paid directly to builders and contractors, subject to the City's approval, and $719,400 represent the assessed value of donated lots.

The investment of $17,600,734 made in Project Homestead, Inc over the years remains in the community and are assets providing housing for our citizens today.

<u>**City's Response:**</u>

(Agency does not address what happened to the profit (CHDO proceeds) if any, from the sales of the $10,313,178 of City funding in single family houses. Agency was not able to show how funds generated were used in the Affordable Housing Program. This is the essence of our audit and the questions the audit was attempting to answer.

Over the years the board of directors, like other stakeholders and investors, accepted the validity and accuracy of the independent audits and the integrity of management and the accounting department during the period in question. As the primary fiduciary agents of the corporation, we must accept some portion of the responsibility for many of the findings revealed in the City's audit. It should be noted, however, that in August 2001, based on the growth of organization (174% in five years) together with a high turnover rate in the accounting department, the board of directors recognized the need to contract the accounting operation to an outside accounting firm.

Project Homestead's independent auditors issued management letters for several years dealing with issues concerning accounting records and internal controls. Unfortunately, until quite recently, the board of directors was not made award of the existence of these letters. The letters were addressed to the President/CEO of Project Homestead through 1999 audit and to the board in subsequent years. It is our understanding that these letters would customarily be addressed to the board or an appropriate committee of the board. Regardless of the addressee, management did not share the letters with the board. Had the board been aware of the comments in the management letters, it would have acted in an appropriate manner.

__City's Response:__

(The Board of Directors had an affirmative duty to exercise its fiduciary responsibility and provide appropriate oversight of the operations of the non-profit.)

COMMINGLING OF FUNDS

1. FINDING:

Project Homestead has not maintained separate bank accounts or general ledger accounts to distinguish funding from their various sources including City of Greensboro funds and the subsequent uses. The agency basically uses one main operating account for deposits and to pay salaries and other expenses incurred by the organization. Due to this commingling of funds, we were not able to determine how much program income was generated from the use of City of Greensboro funding and if any income was reinvested into the Affordable Housing Program in Greensboro. This is not in compliance with the Community Housing Development Organization (CHDO) agreement executed by Project Homestead and the City of Greensboro in May of 1999.

RECOMMENDATION:

Project Homestead should establish separate general ledger accounts or separate bank accounts to distinguish which funding sources were used for each purpose. Further analysis of the Housing Program should be made to determine what, if any funds may be available to repay the City.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:

All of these projects received considerable pre-development/award scrutiny. In order to receive consideration for funding by the City, budgets and project plans were submitted to the City and evaluated. While funds may have been placed in the same account, the project plans were followed and verified through previous audits. Prior to this audit, at no time did the city auditors identify commingling of funds as an issue.

The recommendation of the Internal Audit Division pertaining to establishing separate general ledger accounts to distinguish which funding sources were used for each purpose was implemented in August 2001.

__City's Response:__

(Our audit period covered the years from December 1997-2001. We did not review documentation for the years December 2002 and 2003. We were not given access to records in order to review transactions/documentation of the Agency without restrictions until September 2003. Therefore we had no way to determine that the funds were commingled.)

HOME COSTS AND SALES

2. FINDING:

3. PHI did not have complete records and was unable to provide documentation for all sales and cost of sales transactions we attempted to sample. We selected two units from schedules provided by their outside audit firm to review sales and cost of sales transactions, for which PHI could not provide any documentation on either the cost or the sale of the homes. Of the 101 sales we sampled, approximately 16% of the sales had no verification of income data to determine whether the purchaser was eligible for low-income housing assistance. Three units, 2017 Hearthwood sold in February 1999, 3222 Creek Ridge Road sold in July 2000, and 1705 Lord Foxley sold in June 2000 were sold to over-income individuals. There are eight others that appear to be over-income. (See Appendix A.)

Proof of counseling of purchasers was not sufficient for any of the unit sales reviewed, and eleven sales lacked appraisal values therefore we could not calculate the excess of appraised value over sales value, or "Instant Equity". PHI failed to provide sales data for one sample, and cost data for another.

PHI did not set up a system to allocate administrative overhead to its cost of sales. Funds received were commingled and expenses paid out of the commingled funds. Since funds were commingled, and cannot be distinguished, all costs were counted against income(s) provided by the City of Greensboro.

RECOMMENDATION:

PHI should keep complete records of all sales and cost of sales transactions.

PHI should maintain records of counseling provided to prospective homebuyers and also offer counseling after loan closing. (HUD Mortgagee letter *96-52* requires the nonprofit offer or obtain homeownership counseling for prospective homebuyers and also offer it after loan closing.)

PHI is required to segregate funds received from City of Greensboro assisted sales, and allocate overhead to the various cost/revenue centers set up by its accountants. In order to participate in federal programs, the non-profit is required to maintain complete records demonstrating that it has established stewardship of funds. (HUD Mortgagee letter *96-52)* Federal Circular A-1 10 subsection 21 Standards for Financial Management Systems requires "(a).. recipients relate financial data to performance data and develop unit cost information where practical. (b) Recipients financial management systems shall provide for the following. (1) Accurate, current and complete disclosure of the financial results of each federally sponsored project or program. (2) Records that identify adequately the source and use of funds for federally sponsored activities. (3) Effective control over and accountability for all funds, property and other assets. (4) Comparison of outlays with budget amounts for the award. (5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants and payments by other means for program purposes by the recipient. (6) Written procedures for determining the reasonable allocability and allowability of costs in accordance with provisions of the applicable Federal cost principles and terms and conditions of the award. (7) Accounting records including cost accounting records are supported by source documentation. Federal Circular A-122 is the Cost Principles for Non-Profit Organizations promulgated by the federal government. Section A. 1. "Composition of total costs. The total cost of an award is the sum of allowable direct and allocable indirect costs less any applicable credits. Of the 101 sales we sampled, approximately 16% of the sales had no verification of income data to determine the purchaser was eligible for low-income housing assistance.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:

Project Homestead, Inc. (PHI) accepts the recommendation pertaining to keeping complete records of all sales and cost of sales transactions. However, it should be noted that of the 101 home sales that were sampled between 1997 and 2001, 84 (84%) had verification of income data to substantiate the eligibility of the purchasers. As identified, three units, 2017 Hearthwood, 3222 Creek Ridge Road, and 1705 Lord Foxley, were sold to over-income individuals. The data are not sufficient to determine whether or not the eight additional houses identified by the auditor were sold to over-income individuals.

During 1997 – 2001, PHI had staff persons employed to counsel prospective homebuyers. Counseled families usually came to PHI at various levels of readiness. Counselors were required to develop and implement the Home Ownership Readiness Development (HORD) program individually tailored to each family. For example, PHI staff persons determined the strengths and weaknesses of each prospective homebuyer, including their credit worthiness, explain the terms of the mortgage-including escrow accounts, and counseled them relative to not incurring other debts, having a saving account to pay at least one mortgage payment, and the importance of maintenance. After the closing, the new homeowner would receive a congratulatory letter that included the name of the plumber, electrician, and the companies who installed the air conditioner, carpet, etc.

Prior to the City of Greensboro (CGSO) approving a second mortgage from its Affordable Housing Program, the prospective homebuyer had to show proof of counseling (certificate). Although the PHI records were not sufficient, the City had final sign-off authority on all of these transactions, as required by the banks.

City's Response:

(The City has Project Homestead's certificate indicating that training took place at the real estate loan closings. However, during the course of the audit, Project Homestead was unable to find the appropriate records to support these certifications. The CHDO agreement between the City and Project Homestead stated that records should be maintained and accessible for monitoring visits.)

The board of directors was not aware of the process that was used to allocate administrative overhead to its cost of sales. In August 2001, PHI established a system to segregate funds received from the CGSO assisted sales, and allocate overhead to the various cost/revenue centers.

4. <u>FINDING:</u>

PHI did not maintain reasonable overhead and profit ratios, or cost of sales rates. The National Association of Home Builders, NAHB, recommends an overhead and profit rate of 15% of sales. PHI audited financial statements for the period under audit 1997 through 2001 show an average overhead rate of 29.71%, with a high of 40.97% in 1997 and a low of 24.05% in 1998. PHI's actual overhead percentage as a percentage of sales was twice the rate recommended by the NAHB.

PHI's 1997-2001 sample sales reviewed show cost of sales percentage to sales of only *85.56%,* which would be comparable to those, recommended by the NAHB. However, the audited cost of sales figures for all sales in 1997-2001 show cost of sales of 101.37%. Excess cost of sales booked per the financial statements for the period is 16.37% above the NAHB recommendation, and would indicate a loss before any overhead was added in. Our review of the costs in our sample show that "soft costs" which should be in overhead such as financing, supervision, closing costs, etc. included as cost of sales amounted to 7.7% of sales, and for our sample, duplicate and unsupported costs were 16.03% of sales. It should be noted that we reviewed 59.55% of the costs claimed and that 26.92% of the reviewed costs were unsupported and/or duplicate costs.

Discussions with PHI accounting staff indicate that prior period practice was to allocate cost of sales from an inventory account at the end of the year, instead of as the properties were completed and sold. This contributed to the poor rate of cost of sales, as apparently duplications and overhead costs were put into the cost of sales at the end of the year.

<u>RECOMMENDATION:</u>
PHI should take steps to ensure cost of sales data is segregated to the appropriate units as they are finished and/or sold, and that only allowable costs are included in such cost. The City should not contract with PHI for any future home construction until corrective actions have been taken.

<u>MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:</u>
Using the overhead and profit ratio provided the National Association of Home Builders (NAHB) to evaluate PHI's operations is not a suitable comparison standard. First, the NAHB is an organization consisting of "for-profit" builders and trades people who build-in "cost recovery" at every phase of the construction of a house. This being the case, a 15% overhead and profit margin at the "time of the sale" seems reasonable. Second, PHI is more of a social services agency than a contractor. To wit, contractors, such as those with the NAHB, do not have to hold classes for prospective homeowners to teach them what is involved in owning a home. Most contractors do not have to put together the complicated financial deals that PHI does to sell a house. The application packages, supporting documentation, certifications, legal reports, etc that are needed to compete for grants and second/third mortgages raise the overhead cost per house considerably.

City's Response:

(City research shows that our figures were fair and representative of what the true costs expended should have been. We did not take the raw NAHB figures, but adjusted those figures to allow for the very things the board is alleging. If only the NAHB number were used then O/H would be lower than we calculated, about 12 to 13%. The City of Greensboro separately funded counseling for clients. Thus this cost was not was part of the overhead expenses.)

INSTANT EQUITY

5. FINDING:

We reviewed sales in our sample for "Instant Equity" passed on to homebuyers. "Instant Equity" is defined as the amount of the appraisal of the home in excess of the sales price. PHI did not pass along "Instant Equity" to homebuyers.

PHI was required to pass along its supposed savings to purchasers, in the form of "Instant Equity". For the period under audit, purchasers "Instant Equity", which we could compute was only 6.70% with lots provided by the City of Greensboro, and 2.22% without the added value, (cost), of the lots. We did not determine the effect of discounts received from HUD. The 6.70% "Instant Equity" is an average of $5,057 per unit since the average sales price was $75,516. The average dollar amounts without city lots averaged only $1,801. Additionally, PHI sold rehabilitated units, which it was able to purchase from HUD for a 10% discount. PHI also received a City of Greensboro 2nd Mortgage Note for purchases of 23 of the 31 rehabilitated units in our sample.

RECOMMENDA TION:
PHI should be required in the future to pass on 'Instant Equity" as intended to assist low-income purchasers.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
PHI accepts the finding that sufficient "instant equity" was not always passed along to homebuyers.

City's Response:

(The Board did not exercise its fiduciary responsibility to ensure that the Affordable Housing Program was operating as designed. Homeowners did not receive the benefits that the program was created to provide.)

PERSONNEL POLICIES

6. FINDING:

PHI had no formal policies as to how to deal with employees and/or board members and no formal write-off policy. PHI provided benefits to related parties not available to the general public, which they charged against their cost of sales or otherwise decreased funds available as program income.

- PHI sold an employee a unit, 2017 Hearthwood, in 1999 and accepted a $20,000 note in partial payment as part of the underwriting. PHI wrote off the note to the employee within a month and charged it to cost of sales, unnecessarily increasing these costs by that amount. The employee was over-income for low-income assistance, but PHI paid $3,133.91 of the closing costs and charged this to cost of sales as well.

- PHI sold a board member a unit, 2702B Darden Road, in December 1999 at a price, $71,500, which allowed them 30.58% of "Instant Equity". The unit was on land purchased by the City of Greensboro, and a release deed from the City of Greensboro deed of trust was not obtained. "Instant Equity" for the 1999 year averaged only 8.97%. PHI claimed building costs of $89,606, and the City of Greensboro provided lot was valued at $18,325, which combined with the sales price meant that PHI suffered a loss of approximately $36,500 on the transaction. The board member sold the unit in March 2002 for $106,500.

- PHI gifted a board member eligible for low-income assistance $1,000 in closing costs for the purchase of 1304 Swan Street in February 2000. The closing cost statement for the purchase/sale shows no out of pocket costs for the purchaser. The $1,000 increased PHI cost of sales unnecessarily.

- PHI rehabilitated a board member's home, 2202 Benbow Road, in 2000, and qualified a purchaser with a no-interest City of Greensboro purchase assistance loan on the unit though they did not own it. On June 20, 2000 the house closed to the eligible purchaser, and the board member's son negotiated a quitclaim deed to the purchaser. PHI did not buy the house, and did not have funds to pay for the rehabilitation until July 3, 2000, almost two weeks later. PHI recorded the purchase of the house on July 3, 2000 two minutes before they recorded its sale to the new purchaser. Thus the sale was originally from the board member on June 20th, and PHI rehabilitated the unit. Only after the board member received their funds from the sale did PHI actually buy the house and get money to rehabilitate it.

RECOMMENDATION:
P1-II should be required to develop formal policies for writing off loans and notes. PHI should, also, deal with identity of interest purchasers and sellers as though they were third party purchasers and sellers. (HUD Mortgagee letter *96-52* prohibits non-profit members of the board, employees or others with an identity-of— interest from being beneficiaries of the affordable housing program.) We recommend PHI recover any excessive amounts they have given employees, board members and officers' friends. In any event, if recovery is not successful, PHI should provide the individuals with 1099 statements indicating the economic value received in order that the individuals pay taxes for these economic advantages, and not benefit quite as greatly from the affordable housing program.

Additionally the non-profit should be aware that it is a conflict of interest for a nonprofit to employ staff who also work for and receive financial benefits from a for-profit entity that is providing the nonprofit with services related to the non-profit's affordable housing program. Thus since Homestead Construction of North Carolina is a for-profit entity, none of its employees can be employed by Project Homestead, as was the case when the CEO, a relative and the CFO were employed by both PHI and Homestead Construction in similar roles.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
PHI does have personnel policies in place; however, the agency did not have a formal write-off policy. However, the "Conflict of Interest" policy states that a "director is said to have a conflict of interest when he or she directly or indirectly (through a relative or associate) has an economic interest in a decision to be taken. This fact alone does not make the decision subject to being voided by the organization. The decision is enforceable if (1) the material facts of the conflict were made known to the other directors; (2) the transaction was fair and reasonable; and (3) the vote of majority of directors, not including the director with the conflict, supported the decision."

Any staff recommendation for write-offs that was brought to the attention to the board received the appropriate action. For example, when the transaction pertaining to the Polo Farms property came to the board for action, a $10,000 bonus for the President/CEO was approved and was reflected on his earnings statement.

Regarding the properties on Hearthwood, Darden Road and Benbow Road, the board of directors was not aware of and did not approve these transactions. The President/CEO did not inform the board of the basis or the rationale for his decision. In addition, the Chief Financial Officer during the period is no longer employed with PHI.

City's Response:

(Being a non-profit entity, all monies should be properly expended for the purpose of the agency. The bonus should have been approved by the board before the transaction. Lack of proper oversight by the Board to oversee the operations of PHI failed to ensure that only those qualified individuals or families benefited from the Affordable Housing Program. The Board of Directors should have adopted and followed conflict-of-interest guidelines which would have prevented transactions with employees and board members. According to HUD Regulations, board members breached their fiduciary responsibilities by engaging in direct transactions with the organization. Unless they're participating in a low-income government program with full disclosure and appraisal, such transactions are prohibited.)

BROKER FEES

7. FINDING:

Homestead Realty was indicated on several closing statements as earning a broker's fee for various purchases and sales made by PHI in 1998 and 2001. The funds paid to

Homestead Realty were either deposited to PHI bank accounts, or used to pay purchaser-closing costs. The "broker fees" unnecessarily increased cost of sales, as they were not true costs to PHI.

RECOMMENDATION:

PHI should not be the beneficiary of "broker" costs in purchase and sales transactions. (HUD Mortgagee letter 2001-30 - Appendix A- prohibits sales bonuses and sales incentives for selling or listing real estate brokers/agents.) We researched information with the Department of the Secretary of State for North Carolina, and did not find Homestead Realty listed as a corporation.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:

PHI accepts the recommendation that the agency should not be the beneficiary of "broker" costs in purchase and sales transactions. However, these funds were either deposited in a PHI account or were used to pay purchaser closing. In those instances where the funds were used to pay purchaser-closing costs, the broker fees did not increase the cost of the sale. Further, the board of directors and the corporate attorney are not aware that Homestead Realty was not listed as a corporation in the state of North Carolina.

City's Response:

(Knowingly putting false or inaccurate information on a HUD-1 Closing Statement is a violation of the Federal Real Estate Settlement Procedures Act. Since Homestead Realty was an entity of Project Homestead, it was paying itself in violation of HUD Regulations and federal law.)

RELEASE DEEDS

8. FINDING:

Twenty-six of the units sampled were on lots the City of Greensboro purchased, PHI had no release deeds from any of the deeds of trust for those purchased by the City of Greensboro. Review of the problem by the City of Greensboro Legal Department, indicates that five of the lots were released, twelve were canceled after the sale, and nine of the deeds of trust were still outstanding. Two of the deeds of trust were to/for individuals who owe notes as low-income purchasers, and are, therefore, properly encumbered. The other seven have not been released and the City of Greensboro still has a claim against the properties. One of the seven was sold to an over-income individual.

PHI sold a unit, 3222 Creekridge, in 2000 to an individual whose income was 135% of the median income for single individuals. The lot on which the unit was built was purchased by the City of Greensboro and was provided under a contract requiring that PHI had to sell to a purchaser whose income was 80% or less of the median income for the size household category.

RECOMMENDATION:

PHI should pay the City of Greensboro 1/4 of the cost of the purchase price of the land ($18,386.50), because the land was split up into four lots. PHI, also, did not obtain a deed of trust release deed for the property, and therefore, the transaction does not meet legal requirements.

The City should require the non-profit to repay the City for any sales to ineligible individuals. The nonprofit should develop a checklist to prevent closings from occurring without the proper release deeds. The City should enforce the penalties in its contract when the non-profit does not comply with notice requirements.

As mentioned earlier, due to the commingling of funds we were not able to determine how much program income was generated from the use of funding provided from the City of Greensboro. However, we were able to review documentation and transactions that relates to how funds were used in general in the organization as follows:

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
It was the standard practice of the CGSO to have its outside attorney(s) prepare all release deeds relating to property on which it had a deed of trust and which was being sold to PHI. Those attorneys habitually and policy-wise would grant assurances to the closing attorneys that the release deeds would be prepared and recorded after closing. Since the CGSO was releasing it own lien from it own property, no additional risk was created as a result of the manner in which the City's attorneys proceeded. Any failure to prepare and record the release deeds is clearly the responsibility of the City and its outside attorneys.

Regarding the 3222 Creekridge property, if the City's contract has a reverter clause in it and said contract was recorded or if the City's deed to PHI had such a clause it in, the City could simply exercise its reverter interest and reclaim the property. However, if the City failed to take this legal step to protect itself by recording the contract or deed, the liability lies solely with the City and its attorneys. A release deed would not be an appropriate instrument to use in the Creekridge situation, if the contract with the reverter was not recorded or where the deed did not contain a reverter clause.

Further, the transaction pertaining to the lot and deed of trust release on the Creekridge property was discussed and approved by the city staff; however, it was recently brought to the board's attention that city staff was not authorized to make such an approval, and that the approval had not been allowed by the City's attorney.

City's Response:

(These facts are totally inaccurate. A master note was recorded on June 15, 1998 for this and other properties that the City purchased on behalf of Project Homestead. The purchaser's closing attorney is responsible for requesting and assuring that the property is released from any Notes/Deeds of Trusts prior to closing, not the City. Project Homestead sold this property to Christopher Totten on April 14, 2000; Project Homestead then requested that the City release this property from the Note/DT on April 18, 2000, four days after the sale. Project Homestead

only notified the City that the buyer was over-income when City staff requested, as part of the release process, data on the low and/or moderate-income status of the household. The City did not release this property from the Note/DT. In September 2002, the City requested that Project Homestead repay the City the $18,386.50 spent for the lot purchase.)

FIXED ASSETS/VEHICLES

9. FINDING:

We reviewed a sample of fixed assets to determine the accuracy of Project Homestead's records, to ensure proper control over these assets and that any City of Greensboro interest in these assets is protected. We noted the following:

LOT PURCHASE in POLO FARMS
On May 27, 1998 Project Homestead purchased a lot in the Polo Farms Sub-Division for $65,000. On November 18, 1998 this lot was sold to an officer of the company for $55,000. The Board of Directors Minutes made reference to this transaction in their meeting held in November 1998. We reviewed available documentation related to this transaction and consulted Project Homestead's external auditors Costello Hill & Company. However, we were not able to see the entire transactions and journal entries accounted for in the general ledger. Therefore, we have a scope limitation and cannot determine if this transaction was handled properly. The situation is worthy of question, as it exists, and needs to be explained by PHI.

VEHICLES
We performed an inventory of all motor vehicles listed on the Balance Sheet as of December 31, 2002. All vehicles were visibly accounted for and matched the vehicle identification number on the asset listing.

FINDING:
When we began our audit a Lexus and Lincoln Navigator were not under the control of Project Homestead. A non-employee of Project Homestead was driving the Lexus and (a relative) of an employee was driving the Lincoln Navigator. Both of these situations have since been corrected, but PHI incurred costs unnecessarily while these situations existed.

These problems were allowed to exist because the PHI Board of Directors did not exercise the appropriate fiduciary responsibility, and in fact met only once each year during the period under audit, 1997-2001.

City Response:

(A relative of an Officer of a non-profit company who is not employed by the company should not be operating a vehicle provided by Project Homestead. As stated previously, it was improper for the president to have personal transactions with the company. Officers, Directors and employees should not be operating a vehicle of the non-profit unless approved by the board for business purposes and

included as part of compensation reported as income to the Internal Revenue Service.

RECOMMENDA TION:
The Board of Directors of Project Homestead should exercise appropriate fiduciary responsibility over the officers of the organization to ensure the safeguarding of assets, and that assets of the company are not used for personal or non-business related reasons. The lease payments on these vehicles caused the earnings of the non-profit to be less thereby reducing program income.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
Our outside auditors examined the Polo Farms transaction. Based on the records available, they concluded that the $10,000 shortfall in the price of the lot sold to the President/CEO was treated as a bonus and was included in his income. The information used to reach this conclusion come from several sources and required some interpretation. The City auditor indicates that he could not see all of the entries in the general ledger accounting for this transaction. However, he was shown where a $10,000 increase was reflected in the earnings records of the President/CEO. We feel that the preponderance of the available evidence indicates that the transaction did result in the President/CEO being taxed on the difference in price.

When PHI downsized and new management assumed leadership, these vehicles were recalled and returned to the dealerships within weeks.

City's Response:
(It is totally inappropriate for an officer of the company to use the assets of the company for personal benefit.)

The board of directors met its bylaws' requirement to meet at least one time per year. However, the board did meet at least twice per year, and "special meetings" were called as necessary. The minutes to support these meetings were damaged because they were stored with the other records at the agency's headquarters on Martin L. King, Jr. Drive. Some of the original handwritten minutes were obtained from the board secretary, retyped and provided to the city auditor.

City's Response:
(The Board had a fiduciary responsibility to exercise appropriate oversight over the operations of the organization and a duty to stay completely informed as a board member about all aspects of the organization.)

EXPENSES

10. FINDING:
We reviewed expenses of the organization that increased dramatically during the period under review. These expenses are Legal and Accounting; Contracted Services; Office Supplies; Telephone and Travel.

LEGAL & ACCOUNTING

We reviewed Legal fees for 1997 through 2001 and noticed a dramatic increase in fees per month to approximately $5,000, for the years ended December 1999, 2000 and 2001. This is due to the fact that Project Homestead became involved in outside business projects that required legal expertise. However, we did note some invoices with very little supporting documentation. Accounting fees for the time period audited by us consisted of audit fees for interim work on the financial statements and the yearly audit by the external auditors. Also, during May 2001 an outside Accounting Services Company was hired to keep records and perform accounting services at a rate of approximately $20,000 per month for an initial analysis of the company for three months. These services increased in August of 2001 to approximately $35,000 per month and a final rate of approximately $40,000 per month. These services were no longer provided as of September 2003.

RECOMMENDATION:

PHI should hire and train full-time personnel to perform record keeping and accounting functions. Since funds were commingled, a determination should be made as to which fees apply to the for-profit, non-profit or other non-profits outside of Greensboro; and PHI should substantiate which fees are applicable to City of Greensboro projects and if appropriate, proper reimbursement should be made.

CONTRACTED SERVICES

We reviewed Contracted Services Expense for the years 1997 through 2001. These expenses consisted of contractors and consultants for various projects. The biggest expense in the category was for temporary service agencies hired to perform accounting services from 1997 through 2001. PHI experienced high turnover with these agencies as opposed to hiring and training full-time personnel. In the later part of 2001 an Accounting Services Company was hired to keep records and perform accounting services reducing these fees somewhat.

RECOMMENDATION:

PHI should develop policies and procedures approved by the Board, such as a bid process to obtain competitive prices on services needed for projects outside the day-to-day operations of the business, to maximize the use of public funds.

OFFICE SUPPLIES

We reviewed Office Supplies Expense for the years 1997 through 2001. These expenses consisted of advertising, supplies, and temporary service agency fees. Again, these temporary agency personnel experienced high turnover and incurred substantial fees. The dramatic increase incurred in the years 1999, 2000 and 2001.

RECOMMENDATION:

PHI should develop policies and procedures approved by the Board to acquire supplies and products with vendors that benefit the organization with minimal costs, to maximize the use of public funds.

TELEPHONE

We reviewed Telephone Expenses for the years 1997 through 2001. The telephone numbers we sampled appear to be business and personal based upon "reverse number testing" we performed on the Internet. Several of our samples came back "no match", so we assumed the numbers were unlisted or cell phone numbers. All 25 of the PHI employees were assigned cell phones, pagers and/or walkie-talkies. During late 2000 the organization started doing business in Goldsboro, Kinston and Reidsville, which increased costs. Additionally the organization experienced excessive costs due to users exceeding their allotted base plans on a monthly basis and long distance charges were substantial. We asked for phone logs but the agency does not maintain any.

RECOMMENDATION:

The Board of Directors of Project Homestead should exercise appropriate fiduciary responsibility, require adequate internal controls and consider consolidating existing plans and services to reduce costs, and maximize the use of public funds.

TRAVEL

We reviewed Travel Expenses for the years 1997 through 2001. Various individuals charged the majority of these expenses on the corporate credit cards of the company. A significant amount of these charges lack supporting documentation. We noted other charges on the corporate credit cards that appear to be of a personal nature: firearms; jewelry: clothing; shoes; sporting goods; utilities; cash advances; entertainment tickets; health club membership dues; dry cleaners; grocery stores; drug stores; hair salons; ABC stores; restaurants; airline tickets for spouses of the company and other non-employees; cruises for employees and their spouses; hotels; electronics stores; car maintenance; mobile car washing and others. A review of various expense accounts shows approximately $480,362.05 in personal charges.

FINDING:

Since the items listed above appear to be of a personal nature, this is not in compliance with the Affordable Housing Program in the City of Greensboro and the CHDO Agreement and does not maximize the use of public funds.

RECOMMENDA TION:

The Board of Directors of Project Homestead should exercise the appropriate fiduciary responsibility over officers of the company to ensure that funding of the agency including City of Greensboro funding is spent for the appropriate purpose. Further analysis should be made to determine the appropriate amount to be repaid to the City.

SALES TAX REFUNDS

We reviewed tax refunds received by PHI during 2001 in the amount of $204,062.48. These funds were deposited into a "sweep account", which is a temporary savings account. When funds were needed for operations, funds were transferred to the general operating account with other funds received by PHI and disbursed. As stated earlier the majority of funds were commingled into one main operating account, and we were unable to determine what amount was used for Affordable Housing in Greensboro.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
Many of the transactions alleged to be personal by the CGSO are for grocery stores, restaurants, and hotels. These charges are in Greensboro and in other locations. It is the board of directors' understanding that the President/CEO used his credit card to purchase food for clients, or to provide temporary housing.

City's Response:
(Receipts were not appropriately kept for these transactions. This is not in compliance with the CHDO Agreement that requires records to be maintained by the organization for specified periods of time. Policies and procedures that provided a check and balance on these transactions should have been established.)

The President/CEO and other employees often traveled on business. They visited housing operations in other cities to solicit donations and to receive awards in Raleigh, NC; Atlanta, GA; San Diego, CA and Washington, DC. Meals were often provided to potential donors when they were being solicited both inside and outside of Greensboro.

It was the belief of the President/CEO that PHI had to become aggressive in private fundraising and soliciting donations from celebrities to make the agency self-sufficient. Using fundraising cruises to make the agency self-sufficient was poor judgment.

City's Response:
(These trips do not appear to be a legitimate expense and in keeping with the non-profit's purpose.)

The board of directors is aware of its fiduciary responsibilities and should have established internal control mechanisms; however, the board was not given full, complete and accurate information about the agency's operations, fiscal or otherwise (i.e., expenses, management letters, lease payments, agreements with the city; judgments or liens, etc).

City's Response:
(The Board did not exercise its right to inquire or examine transactions of the organization to ensure that the company had proper internal control mechanisms in place to prevent the misappropriations of funds.)

The agency's expenses increased dramatically because the agency's revenue, and consequent program activities, increased by 174 percent during the audit years. PHI expanded its marketing department and generated new publications, and printed in-house most of their information for potential homebuyers and contributors. Program expansion also increased the demand for additional office supplies.

For the period January 1, 2001 to August 15, 2001, average monthly cost for the accounting department was $51,060. These costs were made up of PHI employees, Temp Agency employees and consultants. Beginning August 16, 2001, all accounting functions were outsourced to a reputable accounting firm with an initial cost of $35,100. That cost increased to $36,855. In September 2002, and the last increase in February 2003 to $39,855 resulted from taking on the accounting responsibilities for the Krispy Kreme Franchise. There are detailed written agreements for all services provided and fee arrangements, all signed and approved by the former President/CEO.

The CGSO auditor has assumed that all of these types of purchases represent non-business or personal expenditures. In fact, it cannot be determined from the available information whether the charges were business or personal. Further, it should be noted that during this period, city funds represented only 11.4 percent of PHI's total income. Unfortunately, the only person who could answer most of these questions is not available.

City's Response:

(The Board had a duty to examine and determine the appropriateness of increasing costs and to ensure that the funds were spent appropriately to carry out the purposes of the organization.)

RECORD KEEPING

11. FINDING:

Project Homestead's system of record keeping is inadequate.

- Project Homestead no longer has many of the payroll files and records. During 2000 and 2001, Project Homestead outsourced its payroll function to ADP, and these payroll records were provided to us for use in conducting our audit. However, for the three years of the audit prior to their switch to ADP, Project Homestead did their payroll in-house. They cannot find any of the payroll records for 1997 or 1998, and produced only a portion of the payroll records from 1999. This drastically reduced the testing we could do in these areas. Our testing of salary advance accounts and repayments is limited to years 2000 and 2001. In 2000 and 2001 bonuses and salaries were grossed up and included in the employees' taxable wages. In 1997, 1998 and 1999 we could not verify whether bonuses recorded in the employees' salary advance accounts were grossed up and included in the employees' taxable wages, nor could we verify whether payroll deductions were made from the employees' salaries to reimburse Project Homestead for amounts due back to the company.

- Another area of inadequate documentation was business receipts and invoices. Since Project Homestead allowed its employees to make personal charges on the company credit cards, it is necessary that the employees produce receipts and/or invoices to substantiate each of their valid business charges. Project Homestead does not have a policy requiring its employees to turn in such documentation as proof of business-related transactions. Without such documentation, it is impossible for Project Homestead to know which expenses are personal and which ones are business-related. It is, therefore, impossible for us to validate the business purposes of some of their credit card charges.

- Project Homestead did have a small portion of records maintained in a very disorganized, sometimes incomprehensible, manner. For example, they had a stack of credit card receipts in a box marked "trash", but the receipts were not in any chronological order, not attached to the related credit card statements, or separated by credit card holders. Project Homestead employees sorted through these receipts at our request and organized them in a way that we could trace them to specific credit card purchases. Still, we found that some of the receipts were completely illegible, while others were merely plain receipts, without any explanation written on them or attached to them describing the business reason for the purchase. Additionally, some of the files and records had been contaminated with pigeon droppings.

As part of its agreement with the City of Greensboro, Project Homestead should immediately keep proper records so that the City can see that its money is being spent in compliance with the grant requirements. Failure to maintain proper records is in violation of this agreement. The City should review all of its contracts with PHI for future direction.

RECOMMENDATION:
The Board of Directors and Officers of Project Homestead should institute the appropriate internal controls and record keeping policies to facilitate the appropriate retention or records and paper trails for compliance with contracts.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
We acknowledge that PHI's accounting records were not as good as they should have been. However, the City auditor was working at a severe disadvantage because of the timing of the audit. None of the employees who generated or posted any of the accounting records were still employed at PHI during the time of the City audit, making it impossible to ask questions regarding the records. It should also be recognized that the records in question ranged from two to six years old. The older records had previously been inspected by the City on a number of occasions and had been placed in storage under the assumption that they would no longer be needed. As you are aware, some of these records had become contaminated due to animal intrusion into the storage area. During the previous audits, the auditor had access to any records that were requested; the auditors examined cash donations, donated lots, overhead accounts and their allocation to houses, among other things. In July 2000, the CGSO stated the audit of PHI was finally finished, PHI's books were in proper order and the CGSO funds were spent as intended.

City's Response:
(Efforts were initiated in 2000 to audit program income (CHDO proceeds), however, the City was not able to audit program income until September 2003 due to obstacles/resistance from the agency for over a two-year time period.

Program specific contracts such as Raymond S. King Apartments, Kingsgate Apartments, New Garden Place Apartments, Alexander Homes and Coley Jenkins Elderly Assisted Living Center were reviewed. In addition to these properties, we reviewed Human Service Contracts; Community Grants for St. Leo's Place at Great Oaks Place Apartments and Coley Jenkins Assisted Living; and Emergency Shelter and Emergency Assistance Grants were monitored to determine if the programs were being operated in accordance with program guidelines. However, during these monitoring visits the complete financial records of the company were withheld by the President of Project Homestead so that a complete financial audit could not be done.)

Many questions are inevitable when examining records of the age and physical condition of the PHI books. With no one available who was involved in the generation of these records available to assist with the records or to answer the questions, it should be expected that there will be unresolved issues regarding the books. We would hope that the CGSO would acknowledge that there might be legitimate explanations for some of the questions that have been raised. However, the age of the records and lack of personnel who were involved to answer those questions make providing those explanations impossible.

PERSONAL EXPENSES

12. FINDING:

Credit card expenses were not properly reconciled between personal and business expense. The CFO was in charge of reconciling Project Homestead's credit card statements. This process involved determining whether charges were personal or business-related, and then coding the charges with the appropriate account numbers. We found the following flaws in this reconciliation process:

- The credit card reconciliations were not reviewed or approved by anyone.

- Only some of the credit card statements were reconciled. Project Homestead did not examine all credit card purchases to distinguish whether the charges were of a business or personal nature. As a result, credit card charges were not always coded to the appropriate accounts. Specifically, over $78,000 in unreconciled credit card expenses was charged to the Miscellaneous Administrative Expense account in 2001. Project Homestead did not provide backup documentation to substantiate that these unreconciled expenses were properly classified as miscellaneous expenses. At the end of the year, Project Homestead reclassified $155,817.78 of Miscellaneous Expenses, charging these expenses to Travel, Auto, Telephone, Meals and other expenses. Project Homestead's accounting staff showed us the journal entry made to record this reclassification, but did not provide any documentation to substantiate (1) the appropriate business purpose for the reclassification, (2) how it was determined which accounts would be charged, or (3) how it was decided what dollar amount would be charged to each of these accounts.

- All of the credit card reconciliations performed were done by the CFO, rather than having a separate employee examine the CFO's own credit card purchases.

- The credit card statements were not always reconciled in a timely manner. Credit card statements were received monthly, but the reconciliations were sometimes being performed months later. Shortly before leaving the company in 2002, the CFO was still going back and reconciling credit card statements from the previous fiscal year.

RECOMMENDATION:
PHI should consider establishing a new policy prohibiting employees from using their corporate credit cards for personal purchases. If the company does not implement such a policy, PHI should develop and implement a formal reconciliation policy, where one individual reconciles the credit card statements each month and another employee is responsible for approving the reconciliations. Within this policy, employees should not be permitted to reconcile their own credit card statements. The diversion of these funds for nonbusiness purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:

See "Management/Board of Directors' response on pages 15-16).

City's Response:
(It is regretful that neither the Board nor the City was advised by the appropriate parties of the continuing problems.)

SALARY ADVANCES/REPAYMENTS

13. FINDING:

Project Homestead failed to charge its employees for many potentially personal charges made on the corporate credit cards.

When personal expenses were charged on the company's credit cards, these expenses were supposed to be charged to the individual employees' salary advance accounts, which are receivable accounts on the general ledger reflecting amounts owed to Project Homestead by its employees. Personal items paid for by Project Homestead and charged to these accounts included cash advances in the employees' salaries, supplies bought to build a personal residence, personal credit card purchases, payments of the employees' insurance premiums, etc. As an employee made personal purchases on the corporate credit card, these purchases should have been charged (debited) to the employee's salary advance account. If the employee repaid the company, either through a payroll deduction or by check reimbursement, the repayment was credited to the employee's salary advance account.

As part of our auditing procedure, we examined the credit card statements for each year. We made a list of credit card purchases that were potentially personal in nature, and asked Project Homestead's management to provide us with documentation substantiating the valid business purpose for each of these charges. They could not provide such documentation for $480,362 of these potentially personal purchases. Next, we compared the amount of potentially personal credit card charges in 2001 and 2000 to the amounts that were charged to the employees' salary advance accounts as personal credit card purchases. These comparisons revealed that Project Homestead only charged $117,044 of the $258,915 unsubstantiated, potentially personal credit card charges to the employees' salary advance accounts. This was only 45.2 1% of the potentially personal charges made in 2001 and 2000, meaning that approximately 54.79% of unsubstantiated, potentially personal credit card charges were charged to the company's business expense accounts. (We could not determine how much of the potentially personal credit card charges made prior to 2000 were charged to the salary advance accounts and repaid to PHI because we were lacking adequate documentation for years 1999, 1998, and 1997.)

RECOMMENDA TION:

The Board of Directors of Project Homestead should institute policies and procedures that will minimize the chances of personal expenses being charged to the company due to an inadequate system of internal controls or the lack of proper credit card reconciliation procedures. The diversion of these funds for nonbusiness purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

REPAYMENTS

FINDING:

Many of the charges debited to the employees' salary advance accounts were not repaid to the company during the period under audit.

We examined the employees' check reimbursements and payroll deductions for 2001 and 2000, the years for which we were provided payroll records, and discovered a significant amount of personal expenses charged to the employees' salary advance accounts that were not repaid to the company. As of December 31, 2001, approximately $57,055 was still due from employees for personal purchases made on the company credit cards in 2001 and 2000. Of this amount, the employees were given bonuses to offset a portion of this. Even after the bonuses were applied, the employees still had not completely paid off what they owed to Project Homestead for purchases made in 2001 and 2000, nor were the repayments enough to cover all of the potential personal charges discussed above.

With regards to the bonuses, we also found that the bonuses were not always recognized in the proper period. For example, there was a $20,000 bonus applied to an employee's salary advance account in year 2000 to offset part of the balance the individual owed to Project Homestead. However, this bonus was not included in the employee's income (per the W-2s) until year 2001. Since the employee received the economic benefit of the bonus in 2000, it therefore should have been recognized as income in year 2000.

RECOMMENDATION:
The Board of Directors of Project Homestead should institute policies and procedures that will minimize the chances of personal expenses being charged to the company due to an inadequate system of internal controls or the lack of proper credit card reconciliation procedures. Additionally, we recommend that any amounts due from employees for personal charges are recovered by PHI or 1099's issued. The diversion of these funds for non-business purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

WRITEOFFS

FINDING:
Many of the charges debited to the salary advance accounts were not repaid to PHI, but instead were written off to various expense accounts. $27,759 of the amounts receivable from employees for personal charges in 2001 and 2000 were written off and charged to the company's expense accounts. Project Homestead could not produce supporting documentation to show (1) why these expenses should be classified as business-related rather than personal, or (2) how they determined which business expense accounts would be charged in this reclassification.

RECOMMENDATION:
The Board of Directors of Project Homestead should institute policies and procedures that will minimize the chances of personal expenses being charged to the company due to an inadequate system of internal controls or the lack of proper credit card reconciliation procedures. Additionally, we recommend that any amounts due from employees for personal charges are recovered by PHI or 1099's issued. The diversion of these funds for non-business purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
The former President/CEO and former Chief Financial Officer consulted and made all decisions concerning write-off advances. The board was not involved in these decisions.

City's Response:
(The Board did not exercise its fiduciary responsibility to ensure assets of the organization were maintained for the benefit of the non-profit by establishing a "write-off" policy approved by the Board. The board should have required that before any write-offs could be made a policy be established with guidelines for this procedure and that the Board or independent financial officers review the write-offs. These, of course, are matters that should have been reported to the Board as a result of its annual external audit.)

NON-EMPLOYEES

14. FINDING:

15. In our examination of the credit card statements, we found a Project Homestead corporate credit card issued in the name of an individual who was not a Project Homestead employee. In 2000 and 1999, there was $10,458.57 worth of purchases charged on the non-employee's PHI corporate credit card. These purchases included charges for clothing, health club memberships, gasoline, entertainment tickets, groceries, restaurants, dry cleaning, and movie rentals.

Because this individual was not an employee, there was not a salary advance account set up to record the credit card purchases made by this individual. Therefore the amounts owed to PHI for these charges were not reimbursed to the company through payroll deductions. Also, there were no other forms of reimbursements discovered for these corporate credit card charges.

RECOMMENDATION:
The Board of Directors should implement a policy stating that company credit cards should only be distributed to Project Homestead employees who have been approved to make business-related purchases and hold corporate credit cards. Additionally, the formal reconciliation policy suggested earlier should require the employee preparing the reconciliations to make sure that all cardholders are valid Project Homestead employees and verify that credit card charges are only made by the employee issued the corporate credit card. The amount above should be recovered by PHI. The diversion of these funds for nonbusiness purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
The board of directors would have no reason to believe that a corporate credit card was issued to a non-employee; therefore, we would not have a policy.

City's Response:

(The Board did not exercise its fiduciary responsibility to ensure that assets of the organization were used to benefit the non-profit by having policies and procedures in place to deter/prohibit unauthorized persons use of company assets for personal gain. The Board should have been informed of these problems by the appropriate officials.)

ADDENDUM

In addition to our audit for the years 1997-2001, the Internal Audit Division received inquiries about the following transactions and therefore examined Project Homestead records to obtain information in response to the inquires:

(1) SALE OF LOTS
PHI sold adjacent parcels of land, 5515 and 5513 Stonebridge, in the Pleasant Garden area to two individuals, April 29, 2002 and January 31, 2003. The first party was charged $68,000 for the land and the second party was also charged $68,000. The second

individual gave PHI a note for $28,000 as a portion of the purchase price. The note was due January 1, 2004. The individual purchasing this property has asked the Board of PHI to forgive the remainder of the debt due on the property due to problems with the property. The note was unpaid at the date of our last day of on site work, January 8, 2004, but was still booked as being due.

RECOMMENDATION:
The Board of PHI should review this transaction as referenced to in their meeting minutes to ensure that PHI is paid fair market value for this property.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
As recommended, the PHI Board of Directors reviewed this property in Pleasant Garden even though no city funds were involved in the purchase. We discovered that a restrictive covenant that prevented an extension of a pond, excessive water flows through the property, approximately 100 loads of dirt were necessary to undergird the pad before a house could be constructed, approximately 50 additional loads of dirt were necessary to build up the yard, and additional grading and pipes were needed. Based on these facts and after consultation with our attorney, the board of directors reaffirmed the President/CEO's decision of April 2001 to forgive the $28,000 note. The board determined that PHI was paid fair market value for this property ($41,000). This decision to forgive the $28,000 note was preferable to canceling the transaction. If the transaction had been canceled, PHI would have had to refund any payments, make the necessary improvements, and hold the property until another buyer could be found. The net financial impact of the second strategy would have been far greater than the $28,000 that was forgiven.

City's Response:
(The Board did not provide an appraisal or documentation to show that this transaction was appropriate.)

(2) PROPERTY at 640 MLK, JR. DRIVE
Project Homestead's Headquarters at 640 Martin Luther King, Jr. Drive was conveyed to the agency on August 2, 1993. This property was designed to provide accommodations for the non-profit to carry out the Affordable Housing Program in Greensboro. If the agency failed to maintain these activities in this building, our agreement, which did not have the appropriate restrictions recorded, stipulated that this property would revert back to the City of Greensboro.

FINDING:
When the City conveyed this building to PHI in 1993, it retained an interest in this property. On January 16, 2002 Project Homestead obtained a loan of $117,292 with this building as collateral. The principal balance on this loan at December 31, 2003 was $109,877.65. The building and records stored there were not maintained per the 1993 agreement and the CHDO Agreement between the City and Project Homestead. Since we began this audit Project Homestead has moved its headquarters to 853 South Elm Street.

RECOMMENDATION:
All reverter clauses in the contract should be stated in the deed and deed of trust and recorded. The Housing & Community Development Department is presently doing this with all its contracts where there is a reverter provision.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE:
PHI did obtain a loan of $117,292 using this building as collateral. The city did not place a restrictive covenant on this property which would have prevented the President/CEO from taking out a loan on this property. It should be noted, however, that improvements were made on this property over the years, including adding a conference room that was also used by the community, and added bathroom facilities.

City's Response:
(This was a legal matter handled by the City's outside attorneys in 1993 and not a matter handled by the City's Housing & Community Development staff. The Contractual Agreement, which is typically not recorded, contained a Reverter Clause. However, pursuant to its contract with the City, Project Homestead had a legal obligation to ensure that this property was used for non-profit purposes and to inform lending institutions of this contract.)

(4) L. RICHARDSON HOSPITAL
An asset of PHI was transferred to a related for-profit entity for less than market value.

On June 14, 1999 Summit Marketing, Incorporated donated the L. Richardson Hospital Building located at 603 Benbow Road to Project Homestead. At the time of donation this building had a tax value at the Guilford County Courthouse of $1,271,300. An appraisal dated April 5,2000 shows a value of $144,000 for the land only. On November 6, 2000 Project Homestead sold the property to L. Richardson Hospital Limited Partnership for $150,000 less Deed Stamps of $300. Project Homestead is a 50% managing member of L. Richardson Limited Partnership. Currently, this property has been fully rehabilitated to apartment units and the City of Greensboro provided a loan to help in this rehabilitation in the amount of $150,000 on March 14, 2002. This principal balance on this loan is $150,000 and no payments are due at this time.

FINDING:
Since Project Homestead only had the land appraised per the instructions of the appraiser and not the building, it clearly appears PHI gave away the assets of the organization to a for-profit entity that they are a managing member of. This clearly appears to be a conflict of interest. (See Mortgagee letter 200 1-30 Appendix C under Conflict of Interest.) L. Richardson Limited Partnership received an asset for $149,700 worth $1,271,300. The resulting effect is the for-profit entity received the benefit of not having to expend an additional $1,121,600 in funds to purchase this property.
RECOMMENDATION:

The Board of Directors of Project Homestead should exercise the appropriate fiduciary responsibility over the officers of the agency to ensure that assets of the agency are protected and not converted for uses that are not beneficial to the non-profit. A further evaluation of the contributed property including the building at the time of transfer should be made by the board. The diversion of this asset diminishes the earnings of the non-profit thereby reducing any program income available to the City.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE
Based on the information available to PHI, this property was transferred appropriately, the building has been completely refurbished and is being used by senior citizens.

City's Response:
(An appropriate appraisal should have been provided to substantiate the value of the building.)

(5) CONSTRUCTION TRAILER
On May 23, 2001 Project Homestead purchased a 2001 Dutchman RV for employees to use in travel to Goldsboro and Kinston. On May 10, 2002 Project Homestead's records show this 2001 RV as being traded for a 1991 Destiny Coach Construction Trailer.

FINDING:
After reviewing documentation of the sale we determined that Project Homestead's records are incorrect. An officer of the company traded the 2001 RV for a 2002 Chariot Construction Trailer for personal use on May 10, 2002. (See HUD Mortgagee Letter 96-52.) On May 22, 2002, PHI renewed a loan against the 2001 RV traded in, even though the item was no longer under their control, and a 1991 Destiny Coach Construction Trailer was substituted for the original collateral by them. However, the bank modification still showed the 2001 RV as collateral for the promissory note. PHI owed $12,231.89 on the loan at November 28, 2003.

RECOMMENDATION:
The Board of Directors of Project Homestead should exercise the appropriate fiduciary responsibility over the officers of the agency to ensure that assets of the agency are protected and not converted for personal use or non-business related reasons. The diversion of this asset diminishes the earnings of the non-profit thereby reducing any program income available to the City.

MANAGEMENT/BOARD OF DIRECTORS' RESPONSE
The appropriate authorities have been notified of this asset and the bankruptcy trustee has the asset included on the liquidation list.

City's Response:
(This is an inappropriate, if not fraudulent transaction of the President of the non-profit. The Board of Project Homestead should have required a system of checks and balances to ensure the organization's assets were not converted for non-business related reasons.)

City of Greensboro

Date: January 16, 2004

To: Ed Kitchen, City Manager

From: Internal Audit

Subject: Project Homestead, Incorporated (PHI) / Program Income Audit

The Internal Audit Division has performed a compliance audit on Program Income and Project Proceeds generated by Project Homestead's use of Federal, State and Local Funding from the City of Greensboro for the years ended 1997 through 2001. During these grant years Project Homestead received approximately $5,785,000 directly and indirectly from the City of Greensboro for their Affordable Housing Program. We augmented our staff with the staff of Cherry Bekaert & Holland our external auditors during this audit. We determined that audit scope limitations existed, in that Project Homestead, Incorporated, (1) could not provide complete payroll records prior to 2000; (2) a portion of the PHI records made available were inappropriately stored and had to be cleaned; (3) and support and explanation of many entries was inadequate.

For purposes of our audit the following definitions are used. *Program Income* is as defined by HUD "gross income received by the recipient or subrecipient directly generated from the use of CDBG, HOME, Bond, Housing Partnership Funds and any other funds used to generate program income." *Gross Income* is defined as "income from the use of rental or real property, owned by the recipient or subrecipient, that was constructed or improved with CDBG, HOME, Bond, Housing Partnership and any other funds, *less* costs incidental to generation of the income." In order to determine program income and project proceeds, sales data, and expenses were reviewed to determine how the income and proceeds were calculated.

COMMINGLING OF FUNDS

FINDING:

Project Homestead has not maintained separate bank accounts or general ledger accounts to distinguish funding from their various sources including City of Greensboro Funds and the subsequent uses. The agency basically uses one main operating account for deposits and to pay salaries and other expenses incurred by the organization. Due to this commingling of funds, we were not able to determine how much program income was generated from the use of City of Greensboro funding and if any income was reinvested into the Affordable Housing Program in Greensboro. This is not in compliance with the Community Housing Development Organization (CHDO) agreement executed by Project Homestead and the City of Greensboro in May of 1999.

RECOMMENDATION:

Project Homestead should establish separate general ledger accounts or separate bank accounts to distinguish which funding sources were used for each purpose. Further analysis of the Housing Program should be made to determine what, if any funds may be available to repay the City.

HOME COSTS and SALES

We reviewed a 25% sample of approximately 400 homes constructed and/or rehabilitated and sold during the years 1997 through 2001 and the findings and recommendations on these 101 homes are summarized below.

FINDING:
PHI did not have complete records and was unable to provide documentation for all sales and cost of sales transactions we attempted to sample. We selected two units from schedules provided by their outside audit firm to review sales and cost of sales transactions, for which PHI could not provide any documentation on either the cost or the sale of the homes.

Of the 101 sales we sampled, approximately 16% of the sales had no verification of income data to determine whether the purchaser was eligible for low-income housing assistance. Three units, 2017 Hearthwood sold in February 1999, 3222 Creek Ridge Road sold in July 2000, and 1705 Lord Foxley sold in June 2001were sold to over-income individuals. There are eight others that appear to be over-income. **(See Appendix A.)**

Proof of counseling of purchasers was not sufficient for any of the unit sales reviewed, and eleven sales lacked appraisal values therefore we could not calculate the excess of appraised value over sales value, or "Instant Equity". PHI failed to provide sales data for one sample, and cost data for another.

PHI did not set up a system to allocate administrative overhead to its cost of sales. Funds received were commingled and expenses paid out of the commingled funds. Since funds were commingled, and cannot be distinguished, all costs were counted against income(s) provided by the City of Greensboro.

RECOMMENDATION:

PHI should keep complete records of all sales and cost of sales transactions.

PHI should maintain records of counseling provided to prospective homebuyers and also offer counseling after loan closing. (HUD Mortgagee letter 96-52 requires the nonprofit offer or obtain homeownership counseling for prospective homebuyers and also offer it after loan closing.)

PHI is required to segregate funds received from City of Greensboro assisted sales, and allocate overhead to the various cost/revenue centers set up by its accountants. In order to participate in federal programs, the non-profit is required to maintain complete records demonstrating that it has established stewardship of funds. (HUD Mortgagee letter 96-52) Federal Circular A-110 subsection 21 Standards for Financial Management Systems requires "(a)…recipients relate financial data to performance data and develop unit cost information where practical. (b) Recipients financial management systems shall provide for the following. (1) Accurate, current and complete disclosure of the financial results of each federally sponsored project or program. …. (2) Records that identify adequately the source and use of funds for federally sponsored activities…. (3) Effective control over and accountability for all funds, property and other assets…. (4) Comparison of outlays with budget amounts for the award…(5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants and payments by other means for program purposes by the recipient. (6) Written procedures for determining the reasonable allocability and allowability of costs in accordance with provisions of the applicable Federal cost principles and terms and conditions of the award. (7) Accounting records including cost accounting records are supported by source documentation…" Federal Circular A-122 is the Cost Principles for Non-Profit Organizations promulgated by the federal government. Section A. 1. "**Composition of total costs.** The total cost of an award is the sum of allowable direct and allocable indirect costs less any applicable credits."….

FINDING:
PHI did not maintain reasonable overhead and profit ratios, or cost of sales rates.

The National Association of Home Builders, NAHB, recommends an overhead and profit rate of 15% of sales. PHI audited financial statements for the period under audit 1997 through 2001 show an average overhead rate of 29.71%, with a high of 40.97% in 1997 and a low of 24.05% in 1998. PHI's actual overhead percentage as a percentage of sales was twice the rate recommended by the NAHB. **(See Exhibit A,** if the overhead and profit rate is 15%, then the cost of sales remainder should be 85%.**)**

PHI's 1997-2001 sample sales reviewed show cost of sales percentage to sales of only 85.56%, which would be comparable to those, recommended by the NAHB. However, the audited cost of sales figures for all sales in 1997-2001 show cost of sales of 101.37%. Excess cost of sales booked per the financial statements for the period is 16.37% above the NAHB recommendation, and would indicate a loss before any overhead was added in. **(See Exhibit B.)** Our review of the costs in our sample show that "soft costs" which should be in overhead such as financing, supervision, closing costs, etc. included as cost of sales amounted to 7.7% of sales, and for our sample, duplicate and unsupported costs were 16.03% of sales. It should be noted that we reviewed 59.55% of the costs claimed and that 26.92% of the reviewed costs were unsupported and/or duplicate costs.

Discussions with PHI accounting staff indicate that prior period practice was to allocate cost of sales from an inventory account at the end of the year, instead of as the properties were completed and sold. This contributed to the poor rate of cost of sales, as apparently duplications and overhead costs were put into the cost of sales at the end of the year.

RECOMMENDATION:
PHI should take steps to ensure cost of sales data is segregated to the appropriate units as they are finished and/or sold, and that only allowable costs are included in such cost. The City should not contract with PHI for any future home construction until corrective actions have been taken.

INSTANT EQUITY
We reviewed sales in our sample for "Instant Equity" passed on to homebuyers. "Instant Equity" is defined as the amount of the appraisal of the home in excess of the sales price.

FINDING:
PHI did not pass along "Instant Equity" to homebuyers.

PHI was required to pass along its supposed savings to purchasers, in the form of "Instant Equity". For the period under audit, purchasers "Instant Equity", which we could compute was only 6.70% with lots provided by the City of Greensboro, and 2.22% without the added value, (cost), of the lots. We did not determine the effect of discounts received from HUD. The 6.70% "Instant Equity" is an average of $5,057 per unit since the average sales price was $75,516. The average dollar amounts without city lots averaged only $1,801. Additionally, PHI sold rehabilitated units, which it was able to purchase from HUD for a 10% discount. PHI also received a City of Greensboro 2nd Mortgage Note for purchases of 23 of the 31 rehabilitated units in our sample.

RECOMMENDATION:
PHI should be required in the future to pass on "Instant Equity" as intended to assist low-income purchasers.

PERSONNEL POLICIES

FINDING:
PHI had no formal policies as to how to deal with employees and/or board members and no formal write-off policy. PHI provided benefits to related parties not available to the general public, which they charged against their cost of sales or otherwise decreased funds available as program income.

- PHI sold an employee a unit, 2017 Hearthwood, in 1999 and accepted a $20,000 note in partial payment as part of the underwriting. PHI wrote off the note to the employee within a month and charged it to cost of sales, unnecessarily increasing these costs by that amount. The employee was over-income for low-income assistance, but PHI paid $3,133.91 of the closing costs and charged this to cost of sales as well.

- PHI sold a board member a unit, 2702B Darden Road, in December 1999 at a price, $71,500, which allowed them 30.58% of "Instant Equity". The unit was on land purchased by the City of Greensboro, and a release deed from the City of Greensboro deed of trust was not obtained. "Instant Equity" for the 1999 year averaged only 8.97%. PHI claimed building costs of $89,606, and the City of Greensboro provided lot was valued at $18,325, which combined with the sales price meant that PHI suffered a loss of approximately $36,500 on the transaction. The board member sold the unit in March 2002 for $106,500.

- PHI gifted a board member eligible for low-income assistance $1,000 in closing costs for the purchase of 1304 Swan Street in February 2000. The closing cost statement for the purchase/sale shows no out of pocket costs for the purchaser. The $1,000 increased PHI cost of sales unnecessarily.

- PHI rehabilitated a board member's home, 2202 Benbow Road, in 2000, and qualified a purchaser with a no-interest City of Greensboro purchase assistance loan on the unit though they did not own it. On June 20, 2000 the house closed to the eligible purchaser, and the board member's son negotiated a quitclaim deed to the purchaser. PHI did not buy the house, and did not have funds to pay for the rehabilitation until July 3, 2000, almost two weeks later. PHI recorded the purchase of the house on July 3, 2000 two minutes before they recorded its sale to the new purchaser. Thus the sale was originally from the board member on June 20th, and PHI rehabilitated the unit. Only after the board member received their funds from the sale did PHI actually buy the house and get money to rehabilitate it.

RECOMMENDATION:
PHI should be required to develop formal policies for writing off loans and notes. PHI should, also, deal with identity of interest purchasers and sellers as though they were third party purchasers and sellers. (HUD Mortgagee letter 96-52 prohibits non-profit members of the board, employees or others with an identity-of-interest from being beneficiaries of the affordable housing program.) We recommend PHI recover any excessive amounts they have given employees, board members and officers' friends. In any event, if recovery is not successful, PHI should provide the individuals with 1099 statements indicating the economic value received in order that the individuals pay taxes for these economic advantages, and not benefit quite as greatly from the affordable housing program.

Additionally the non-profit should be aware that it is a conflict of interest for a nonprofit to employ staff who also work for and receive financial benefits from a for-profit entity that is providing the nonprofit with services related to the non-profit's affordable housing program. Thus since Homestead Construction of North Carolina is a for-profit entity, none of its employees can be employed by Project Homestead, as was the case when the CEO, a relative and the CFO were employed by both PHI and Homestead Construction in similar roles. (See Mortgagee letter 2001-30 Appendix C under Conflict of Interest.)

BROKER FEES

FINDING:

Homestead Realty was indicated on several closing statements as earning a broker's fee for various purchases and sales made by PHI in 1998 and 2001. The funds paid to Homestead Realty were either deposited to PHI bank accounts, or used to pay purchaser-closing costs. The "broker fees" unnecessarily increased cost of sales, as they were not true costs to PHI.

RECOMMENDATION:

PHI should not be the beneficiary of "broker" costs in purchase and sales transactions. (HUD Mortgagee letter 2001-30 - Appendix A- prohibits sales bonuses and sales incentives for selling or listing real estate brokers/agents.) We researched information with the Department of the Secretary of State for North Carolina, and did not find Homestead Realty listed as a corporation.

RELEASE DEEDS

FINDING:

Twenty-six of the units sampled were on lots the City of Greensboro purchased, PHI had no release deeds from any of the deeds of trust for those purchased by the City of Greensboro. Review of the problem by the City of Greensboro Legal Department, indicates that five of the lots were released, twelve were canceled after the sale, and nine of the deeds of trust were still outstanding. Two of the deeds of trust were to/for individuals who owe notes as low-income purchasers, and are, therefore, properly encumbered. The other seven have not been released and the City of Greensboro still has a claim against the properties. One of the seven was sold to an over-income individual.

PHI sold a unit, 3222 Creekridge, in 2000 to an individual whose income was 135% of the median income for single individuals. The lot on which the unit was built was purchased by the City of Greensboro and was provided under a contract requiring that PHI had to sell to a purchaser whose income was 80% or less of the median income for the size household category.

RECOMMENDATION:

PHI should pay the City of Greensboro ¼ of the cost of the purchase price of the land ($18,386.50), because the land was split up into four lots. PHI, also, did not obtain a deed of trust release deed for the property, and therefore, the transaction does not meet legal requirements.

The City should require the non-profit to repay the City for any sales to ineligible individuals. The non-profit should develop a checklist to prevent closings from occurring without the proper release deeds. The City should enforce the penalties in its contract when the non-profit does not comply with notice requirements.

****

As mentioned earlier, due to the commingling of funds we were not able to determine how much program income was generated from the use of funding provided from the City of Greensboro. However, we were able to review documentation and transactions that relates to how funds were used in general in the organization as follows:

FIXED ASSETS / VEHICLES

We reviewed a sample of fixed assets to determine the accuracy of Project Homestead's records, to ensure proper control over these assets and that any City of Greensboro interest in these assets is protected. We noted the following:

LOT PURCHASE in POLO FARMS

On May 27, 1998 Project Homestead purchased a lot in the Polo Farms Sub-Division for $65,000. On November 18, 1998 this lot was sold to an officer of the company for $55,000. The Board of Directors Minutes made reference to this transaction in their meeting held in November 1998. We reviewed available documentation related to this transaction and consulted Project Homestead's external auditors Costello Hill & Company. However, we were not able to see the entire transactions and journal entries accounted for in the general ledger. Therefore, we have a scope limitation and cannot determine if this transaction was handled properly. The situation is worthy of question, as it exists, and needs to be explained by PHI.

VEHICLES

We performed an inventory of all motor vehicles listed on the Balance Sheet as of December 31, 2002. All vehicles were visibly accounted for and matched the vehicle identification number on the asset listing.

FINDING:

When we began our audit a Lexus and Lincoln Navigator were not under the control of Project Homestead. A non-employee of Project Homestead was driving the Lexus and (a relative) of an employee was driving the Lincoln Navigator. Both of these situations have since been corrected, but PHI incurred costs unnecessarily while these situations existed.

These problems were allowed to exist because the PHI Board of Directors did not exercise the appropriate fiduciary responsibility, and in fact met only once each year during the period under audit, 1997-2001.

RECOMMENDATION:

The Board of Directors of Project Homestead should exercise appropriate fiduciary responsibility over the officers of the organization to ensure the safeguarding of assets, and that assets of the company are not used for personal or non-business related reasons. The lease payments on these vehicles caused the earnings of the non-profit to be less thereby reducing program income.

EXPENSES

We reviewed expenses of the organization that increased dramatically during the period under review. These expenses are Legal and Accounting; Contracted Services; Office Supplies; Telephone and Travel. An analysis of these expenses are found in **Exhibit C**, and a brief summary of each is noted below:

LEGAL & ACCOUNTING

We reviewed Legal fees for 1997 through 2001 and noticed a dramatic increase in fees per month to approximately $5,000, for the years ended December 1999, 2000 and 2001. This is due to the fact that Project Homestead became involved in outside business projects that required legal expertise. However, we did note some invoices with very little supporting documentation. Accounting fees for the time period audited by us consisted of audit fees for interim work on the financial statements and the yearly audit by the external auditors. Also, during May 2001 an outside Accounting Services Company was hired to keep records and perform accounting services at a rate of approximately $20,000 per month for an initial analysis of the company for three months. These services increased in August of 2001 to approximately $35,000 per month and a final rate of approximately $40,000 per month. These services were no longer provided as of September 2003.

RECOMMENDATION:
PHI should hire and train full-time personnel to perform record keeping and accounting functions. Since funds were commingled, a determination should be made as to which fees apply to the for-profit, non-profit or other non-profits outside of Greensboro; and PHI should substantiate which fees are applicable to City of Greensboro projects and if appropriate, proper reimbursement should be made.

CONTRACTED SERVICES
We reviewed Contracted Services Expense for the years 1997 through 2001. These expenses consisted of contractors and consultants for various projects. The biggest expense in the category was for temporary service agencies hired to perform accounting services from 1997 through 2001. PHI experienced high turnover with these agencies as opposed to hiring and training full-time personnel. In the later part of 2001 an Accounting Services Company was hired to keep records and perform accounting services reducing these fees somewhat.

RECOMMENDATION:
PHI should develop policies and procedures approved by the Board, such as a bid process to obtain competitive prices on services needed for projects outside the day-to-day operations of the business, to maximize the use of public funds.

OFFICE SUPPLIES
We reviewed Office Supplies Expense for the years 1997 through 2001. These expenses consisted of advertising, supplies, and temporary service agency fees. Again, these temporary agency personnel experienced high turnover and incurred substantial fees. The dramatic increase incurred in the years 1999, 2000 and 2001.

RECOMMENDATION:
PHI should develop policies and procedures approved by the Board to acquire supplies and products with vendors that benefit the organization with minimal costs, to maximize the use of public funds.

TELEPHONE
We reviewed Telephone Expenses for the years 1997 through 2001. The telephone numbers we sampled appear to be business and personal based upon "reverse number testing" we performed on the Internet. Several of our samples came back "no match", so we assumed the numbers were unlisted or cell phone numbers. All 25 of the PHI employees were assigned cell phones, pagers and/or walkie-talkies. During late 2000 the organization started doing business in Goldsboro, Kinston and Reidsville, which increased costs. Additionally the organization experienced excessive costs due to users exceeding their allotted base plans on a monthly basis and long distance charges were substantial. We asked for phone logs but the agency does not maintain any.

RECOMMENDATION:
The Board of Directors of Project Homestead should exercise appropriate fudiciary responsibility, require adequate internal controls and consider consolidating existing plans and services to reduce costs, and maximize the use of public funds.

TRAVEL
We reviewed Travel Expenses for the years 1997 through 2001. Various individuals charged the majority of these expenses on the corporate credit cards of the company. A significant amount of these charges lack supporting documentation. We noted other charges on the corporate credit cards that appear to be of a personal nature: firearms; jewelry; clothing; shoes; sporting goods; utilities; cash advances; entertainment

tickets; health club membership dues; dry cleaners; grocery stores; drug stores; hair salons; ABC stores; restaurants; airline tickets for spouses of the company and other non-employees; cruises for employees and their spouses; hotels; electronics stores; car maintenance; mobile car washing and others. A review of various expense accounts shows approximately $480,362.05 in personal charges. **Exhibit D** shows additional travel information and charges incurred by year.

FINDING:

Since the items listed above appear to be of a personal nature, this is not in compliance with the Affordable Housing Program in the City of Greensboro and the CHDO Agreement and does not maximize the use of public funds.

RECOMMENDATION:

The Board of Directors of Project Homestead should exercise the appropriate fiduciary responsibility over officers of the company to ensure that funding of the agency including City of Greensboro funding is spent for the appropriate purpose. Further analysis should be made to determine the appropriate amount to be repaid to the City.

SALES TAX REFUNDS

We reviewed tax refunds received by PHI during 2001 in the amount of $204,062.48. These funds were deposited into a "sweep account", which is a temporary savings account. When funds were needed for operations, funds were transferred to the general operating account with other funds received by PHI and disbursed. As stated earlier the majority of funds were commingled into one main operating account, and we were unable to determine what amount was used for Affordable Housing in Greensboro.

RECORD KEEPING

FINDING:

Project Homestead's system of record keeping is inadequate.

- Project Homestead no longer has many of the payroll files and records. During 2000 and 2001, Project Homestead outsourced its payroll function to ADP, and these payroll records were provided to us for use in conducting our audit. However, for the three years of the audit prior to their switch to ADP, Project Homestead did their payroll in-house. They cannot find any of the payroll records for 1997 or 1998, and produced only a portion of the payroll records from 1999. This drastically reduced the testing we could do in these areas. Our testing of salary advance accounts and repayments is limited to years 2000 and 2001. In 2000 and 2001 bonuses and salaries were grossed up and included in the employees' taxable wages. In 1997, 1998 and 1999 we could not verify whether bonuses recorded in the employees' salary advance accounts were grossed up and included in the employees' taxable wages, nor could we verify whether payroll deductions were made from the employees' salaries to reimburse Project Homestead for amounts due back to the company.

- Another area of inadequate documentation was business receipts and invoices. Since Project Homestead allowed its employees to make personal charges on the company credit cards, it is necessary that the employees produce receipts and/or invoices to substantiate each of their valid business charges. Project Homestead does not have a policy requiring its employees to turn in such documentation as proof of business-related transactions. Without such documentation, it is impossible for Project Homestead to know which expenses are personal and which ones are business-related. It is, therefore, impossible for us to validate the business purposes of some of their credit card charges.

- Project Homestead did have a small portion of records maintained in a very disorganized, sometimes incomprehensible, manner. For example, they had a stack of credit card receipts in a box marked "trash", but the receipts were not in any chronological order, not attached to the related credit card statements, or separated by credit card holders. Project Homestead employees sorted through these receipts at our request and organized them in a way that we could trace them to specific credit card purchases. Still, we found that some of the receipts were completely illegible, while others were merely plain receipts, without any explanation written on them or attached to them describing the business reason for the purchase. Additionally, some of the files and records had been contaminated with pigeon droppings.

As part of its agreement with the City of Greensboro, Project Homestead should immediately keep proper records so that the City can see that its money is being spent in compliance with the grant requirements. Failure to maintain proper records is in violation of this agreement. The City should review all of its contracts with PHI for future direction.

RECOMMENDATION:
The Board of Directors and Officers of Project Homestead should institute the appropriate internal controls and record keeping policies to facilitate the appropriate retention or records and paper trails for compliance with contracts.

PERSONAL EXPENSES

FINDING:
Credit card expenses were not properly reconciled between personal and business expense.

The CFO was in charge of reconciling Project Homestead's credit card statements. This process involved determining whether charges were personal or business-related, and then coding the charges with the appropriate account numbers. We found the following flaws in this reconciliation process:

- The credit card reconciliations were not reviewed or approved by anyone.

- Only some of the credit card statements were reconciled. Project Homestead did not examine all credit card purchases to distinguish whether the charges were of a business or personal nature. As a result, credit card charges were not always coded to the appropriate accounts. Specifically, over $78,000 in unreconciled credit card expenses was charged to the Miscellaneous Administrative Expense account in 2001. Project Homestead did not provide backup documentation to substantiate that these unreconciled expenses were properly classified as miscellaneous expenses. At the end of the year, Project Homestead reclassified $155,817.78 of Miscellaneous Expenses, charging these expenses to Travel, Auto, Telephone, Meals and other expenses. Project Homestead's accounting staff showed us the journal entry made to record this reclassification, but did not provide any documentation to substantiate (1) the appropriate business purpose for the reclassification, (2) how it was determined which accounts would be charged, or (3) how it was decided what dollar amount would be charged to each of these accounts.
- All of the credit card reconciliations performed were done by the CFO, rather than having a separate employee examine the CFO's own credit card purchases.

- The credit card statements were not always reconciled in a timely manner. Credit card statements were received monthly, but the reconciliations were sometimes being performed months later.

Shortly before leaving the company in 2002, the CFO was still going back and reconciling credit card statements from the previous fiscal year.

RECOMMENDATION:
PHI should consider establishing a new policy prohibiting employees from using their corporate credit cards for personal purchases. If the company does not implement such a policy, PHI should develop and implement a formal reconciliation policy, where one individual reconciles the credit card statements each month and another employee is responsible for approving the reconciliations. Within this policy, employees should not be permitted to reconcile their own credit card statements. The diversion of these funds for non-business purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

SALARY ADVANCES

FINDING:
Project Homestead failed to charge its employees for many potentially personal charges made on the corporate credit cards.

When personal expenses were charged on the company's credit cards, these expenses were supposed to be charged to the individual employees' salary advance accounts, which are receivable accounts on the general ledger reflecting amounts owed to Project Homestead by its employees. Personal items paid for by Project Homestead and charged to these accounts included cash advances in the employees' salaries, supplies bought to build a personal residence, personal credit card purchases, payments of the employees' insurance premiums, etc. As an employee made personal purchases on the corporate credit card, these purchases should have been charged (debited) to the employee's salary advance account. If the employee repaid the company, either through a payroll deduction or by check reimbursement, the repayment was credited to the employee's salary advance account.

As part of our auditing procedure, we examined the credit card statements for each year. We made a list of credit card purchases that were potentially personal in nature, and asked Project Homestead's management to provide us with documentation substantiating the valid business purpose for each of these charges. They could not provide such documentation for $480,362 of these potentially personal purchases. Next, we compared the amount of potentially personal credit card charges in 2001 and 2000 to the amounts that were charged to the employees' salary advance accounts as personal credit card purchases. These comparisons revealed that Project Homestead only charged $117,044 of the $258,915 unsubstantiated, potentially personal credit card charges to the employees' salary advance accounts. This was only 45.21% of the potentially personal charges made in 2001 and 2000, meaning that approximately 54.79% of unsubstantiated, potentially personal credit card charges were charged to the company's business expense accounts. (We could not determine how much of the potentially personal credit card charges made prior to 2000 were charged to the salary advance accounts and repaid to PHI because we were lacking adequate documentation for years 1999, 1998, and 1997.)

RECOMMENDATION:
The Board of Directors of Project Homestead should institute policies and procedures that will minimize the chances of personal expenses being charged to the company due to an inadequate system of internal controls or the lack of proper credit card reconciliation procedures. The diversion of these funds for non-business purposes reduced program income which would have been available to the City for additional investment in affordable housing.

REPAYMENTS

FINDING:
Many of the charges debited to the employees' salary advance accounts were not repaid to the company during the period under audit.

We examined the employees' check reimbursements and payroll deductions for 2001 and 2000, the years for which we were provided payroll records, and discovered a significant amount of personal expenses charged to the employees' salary advance accounts that were not repaid to the company. As of December 31, 2001, approximately $57,055 was still due from employees for personal purchases made on the company credit cards in 2001 and 2000. Of this amount, the employees were given bonuses to offset a portion of this. Even after the bonuses were applied, the employees still had not completely paid off what they owed to Project Homestead for purchases made in 2001 and 2000, nor were the repayments enough to cover all of the potential personal charges discussed above.

With regards to the bonuses, we also found that the bonuses were not always recognized in the proper period. For example, there was a $20,000 bonus applied to an employee's salary advance account in year 2000 to offset part of the balance the individual owed to Project Homestead. However, this bonus was not included in the employee's income (per the W-2s) until year 2001. Since the employee received the economic benefit of the bonus in 2000, it therefore should have been recognized as income in year 2000.

RECOMMENDATION:
The Board of Directors of Project Homestead should institute policies and procedures that will minimize the chances of personal expenses being charged to the company due to an inadequate system of internal controls or the lack of proper credit card reconciliation procedures. Additionally, we recommend that any amounts due from employees for personal charges are recovered by PHI or 1099's issued. The diversion of these funds for non-business purposes reduced program income which would have been available to the City for additional investment in affordable housing.

WRITEOFFS

FINDING:
Many of the charges debited to the salary advance accounts were not repaid to PHI, but instead were written off to various expense accounts. $27,759 of the amounts receivable from employees for personal charges in 2001 and 2000 were written off and charged to the company's expense accounts. Project Homestead could not produce supporting documentation to show (1) why these expenses should be classified as business-related rather than personal, or (2) how they determined which business expense accounts would be charged in this reclassification.

RECOMMENDATION:
The Board of Directors of Project Homestead should institute policies and procedures that will minimize the chances of personal expenses being charged to the company due to an inadequate system of internal controls or the lack of proper credit card reconciliation procedures. Additionally, we recommend that any amounts due from employees for personal charges are recovered by PHI or 1099's issued. The diversion of these funds for non-business purposes reduced program income which would have been available to the City for additional investment in affordable housing.

NON-EMPLOYEES

FINDING:

In our examination of the credit card statements, we found a Project Homestead corporate credit card issued in the name of an individual who was not a Project Homestead employee. In 2000 and 1999, there was $10,458.57 worth of purchases charged on the non-employee's PHI corporate credit card. These purchases included charges for clothing, health club memberships, gasoline, entertainment tickets, groceries, restaurants, dry cleaning, and movie rentals.

Because this individual was not an employee, there was not a salary advance account set up to record the credit card purchases made by this individual. Therefore the amounts owed to PHI for these charges were not reimbursed to the company through payroll deductions. Also, there were no other forms of reimbursements discovered for these corporate credit card charges.

RECOMMENDATION:

The Board of Directors should implement a policy stating that company credit cards should only be distributed to Project Homestead employees who have been approved to make business-related purchases and hold corporate credit cards. Additionally, the formal reconciliation policy suggested earlier should require the employee preparing the reconciliations to make sure that all cardholders are valid Project Homestead employees and verify that credit card charges are only made by the employee issued the corporate credit card. The amount above should be recovered by PHI. The diversion of these funds for non-business purposes reduced program income, which would have been available to the City for additional investment in affordable housing.

CONCLUSION:

The audit contained numerous occasions of commingling of funds; failure to maintain proper accounts and accountability; and the diversion of funds to non City of Greensboro uses. Therefore, we recommend the City of Greensboro not fund this agency until the appropriate safeguards and internal controls are in place and all funds due from employees and non-employees for personal expenses are repaid. As in our contract the City should require PHI "to maintain, for a minimum of five years accurate and complete records of all organization financial transactions which occur during this agreement." The City may also consider other appropriate action as necessary.

ADDENDUM

In addition to our audit for the years 1997-2001, the Internal Audit Division received inquiries about the following transactions and therefore examined Project Homestead records to obtain information in response to the inquires:

SALE OF LOTS

PHI sold adjacent parcels of land, 5515 and 5513 Stonebridge, in the Pleasant Garden area to two individuals, April 29, 2002 and January 31, 2003. The first party was charged $68,000 for the land and the second party was also charged $68,000. The second individual gave PHI a note for $28,000 as a portion of the purchase price. The note was due January 1, 2004. The individual purchasing this property has asked the Board of PHI to forgive the remainder of the debt due on the property due to problems with the property. The note was unpaid at the date of our last day of on site work, January 8, 2004, but was still booked as being due.

RECOMMENDATION:

The Board of PHI should review this transaction as referenced to in their meeting minutes to ensure that PHI is paid fair market value for this property.

PROPERTY at 640 MLK, JR. DRIVE

Project Homestead's Headquarters at 640 Martin Luther King, Jr. Drive was conveyed to the agency on August 2, 1993. This property was designed to provide accommodations for the non-profit to carry out the Affordable Housing Program in Greensboro. If the agency failed to maintain these activities in this building, our agreement, which did not have the appropriate restrictions recorded, stipulated that this property would revert back to the City of Greensboro.

FINDING:

When the City conveyed this building to PHI in 1993, it retained an interest in this property. On January 16, 2002 Project Homestead obtained a loan of $117,292 with this building as collateral. The principal balance on this loan at December 31, 2003 was $109,877.65. The building and records stored there were not maintained per the 1993 agreement and the CHDO Agreement between the City and Project Homestead. Since we began this audit Project Homestead has moved its headquarters to 853 South Elm Street.

RECOMMENDATION:

All reverter clauses in the contract should be stated in the deed and deed of trust and recorded. The Housing & Community Development Department is presently doing this with all its contracts where there is a reverter provision.

L. RICHARDSON HOSPITAL

An asset of PHI was transferred to a related for-profit entity for less than market value.

On June 14, 1999 Summit Marketing, Incorporated donated the L. Richardson Hospital Building located at 603 Benbow Road to Project Homestead. At the time of donation this building had a tax value at the Guilford County Courthouse of $1,271,300. An appraisal dated April 5, 2000 shows a value of $144,000 for the land only. On November 6, 2000 Project Homestead sold the property to L. Richardson Hospital Limited Partnership for $150,000 less Deed Stamps of $300. Project Homestead is a 50% managing member of L. Richardson Limited Partnership. Currently, this property has been fully rehabilitated to apartment units and the City of Greensboro provided a loan to help in this rehabilitation in the amount of

$150,000 on March 14, 2002. This principal balance on this loan is $150,000 and no payments are due at this time.

FINDING:

Since Project Homestead only had the land appraised per the instructions of the appraiser and not the building, it clearly appears PHI gave away the assets of the organization to a for-profit entity that they are a managing member of. This clearly appears to be a conflict of interest. (See Mortgagee letter 2001-30 Appendix C under Conflict of Interest.) L. Richardson Limited Partnership received an asset for $149,700 worth $1,271,300. The resulting effect is the for-profit entity received the benefit of not having to expend an additional $1,121,600 in funds to purchase this property.

RECOMMENDATION:

The Board of Directors of Project Homestead should exercise the appropriate fiduciary responsibility over the officers of the agency to ensure that assets of the agency are protected and not converted for uses that are not beneficial to the non-profit. A further evaluation of the contributed property including the building at the time of transfer should be made by the board. The diversion of this asset diminishes the earnings of the non-profit thereby reducing any program income available to the City.

CONSTRUCTION TRAILER

On May 23, 2001 Project Homestead purchased a 2001 Dutchman RV for employees to use in travel to Goldsboro and Kinston. On May 10, 2002 Project Homestead's records show this 2001 RV as being traded for a 1991 Destiny Coach Construction Trailer.

FINDING:

After reviewing documentation of the sale we determined that Project Homestead's records are incorrect. An officer of the company traded the 2001 RV for a 2002 Chariot Construction Trailer for personal use on May 10, 2002. (See HUD Mortgagee Letter 96-52.) On May 22, 2002, PHI renewed a loan against the 2001 RV traded in, even though the item was no longer under their control, and a 1991 Destiny Coach Construction Trailer was substituted for the original collateral by them. However, the bank modification still showed the 2001 RV as collateral for the promissory note. PHI owed $12,231.89 on the loan at November 28, 2003.

RECOMMENDATION:

The Board of Directors of Project Homestead should exercise the appropriate fiduciary responsibility over the officers of the agency to ensure that assets of the agency are protected and not converted for personal use or non-business related reasons. The diversion of this asset diminishes the earnings of the non-profit thereby reducing any program income available to the City.

We require a response to our recommendations from Project Homestead's Management, The Board of Directors of Project Homestead and our Housing & Community Development Department within 45 days of the date of this report. If there are any questions or comments concerning the details of this audit, we can be reached at 373-2821.

Fred Newnam

Fred Newnam
Internal Auditor

Len Lucas
Acting Internal Audit Director

Enclosures:
- Appendix A: Sales to over income purchasers
- Exhibit A: Analysis of overhead reasonableness
- Exhibit B: Analysis of cost of sales reasonableness
- Exhibit C: Analysis of expenses
- Exhibit D: Analysis of total personal credit card charges and travel expenses

Cc: Mitchell Johnson, Deputy City Manager
Ben Brown, Assistant City Manager for Economic Development
Bob Morgan, Assistant City Manager
Linda Miles, City Attorney
Andy Scott, Director of Housing & Community Development
Dr. Alton Thompson, Chairman of the Board of Directors for Project Homestead, Incorporated
Cherry, Bekaert & Holland, LLP

APPENDIX A

PPOPERTIES THAT APPEAR TO BEEN SOLD TO OVER INCOME PURCHASERS

YEAR	ADDRESS	SALES PRICE
1997	4652 Penn Oak	$84,500
1998	1 Baytree Court	$223,000
1998	4 Sedley Court	$98,000
1999	4809 Shady Pine	$81,500
1999	3412 Argyle	$102,000
2001	801 Blazingwood	$105,000
2001	4617 Eagle Rock	$103,770
2001	5514-B Richland	$80,000

Prepared by Internal Audit
1/15/04

EXHIBIT A

PROJECT HOMESTEAD, INC. OVERHEAD
PROJECT HOMESTEAD
ANALYSIS OF OVERHEAD REASONABLENESS

	1997	1998	1999	2000	2001	TOTALS
REAL ESTATE SALES (1)	3,241,300.00	7,265,685.00	8,959,806.00	8,631,036.00	9,178,461.00	37,276,288.00
NON COST OF REAL ESTATE SALES EXPENSES (OVERHEAD)(2)	1,327,589.00	1,746,544.00	2,250,796.00	2,688,589.00	3,062,835.00	11,076,353.00
% OF OVERHEAD EXPENSES TO SALES	40.96%	24.04%	25.12%	31.15%	33.37%	29.71%
OVERHEAD RATE NAHB (3)	15%	15%	15%	15%	15%	15%
OVERHEAD DOLLARS AT 15%	486,195.00	1,089,852.75	1,343,970.90	1,294,655.40	1,376,769.15	5,591,443.20
EXCESS % OF OVERHEAD	25.96%	9.04%	10.12%	16.15%	18.37%	14.71%
EXCESS DOLLARS OF OVERHEAD	$841,394.00	$656,691.25	$906,825.10	$1,393,933.60	$1,686,065.85	$5,484,909.80

SOURCE:
(1) and (2) = REVENUE AND EXPENDITURES FROM PHI AUDITED FINANCIAL STATEMENTS
(3) = OVERHEAD RATE FROM INDUSTRY STANDARDS IN CONSTRUCTION, NATIONAL ASSOCIATION OF HOMEBUILDERS, "THE BUSINESS OF BUILDING, MEASURING YOUR SUCCESS, 2001 COST OF DOING BUSINESS STUDY."
RATE IS PRODUCTION BUILDERS WITH $3 MILLION TO $15 MILLION REVENUE ADJUSTED TO TAKE OUT OWNER'S COMPENSATION AND 1/3 OF NET PROFIT MARGIN BEFORE TAXES SINCE A NON PROFIT DOES NOT OWE ANY OWNER COMPENSATION AND SHOULD NOT HAVE A PROFIT BEFORE TAX MARGIN, SINCE A NON PROFIT IS NOT TAXED.

WORK PERFORMED:
COMPARED PHI ACTUAL OVERHEAD AND ITS PERCENTAGE TO THE PERCENTAGES AND DOLLARS FROM 1997 TO 2001 WHICH WOULD HAVE BEEN OBTAINED BY USE OF INDUSTRY STANDARDS TO DETERMINE REASONABLENESS OF PHI ACTUAL OVERHEAD.

CONCLUSION:
PHI ACTUAL OVERHEAD PERCENTAGES AND DOLLARS ARE APPROXIMATELY TWICE AS MUCH AS RECOMMENDED BY THE NATIONAL ASSOCIATION OF HOME BUILDERS. THE RATES AND DOLLARS ARE NOT REASONABLE TO THE SALES DOLLARS.

THE TOTAL AMOUNT EXCESSIVE FOR THE FIVE YEAR PERIOD UNDER STUDY IS $5,484,910, AND AVERAGES $1,096,982 PER YEAR.

Prepared by Internal Audit
1/9/04

EXHIBIT B

PROJECT HOMESTEAD, INC. COST OF SALES

PROJECT HOMESTEAD
ANALYSIS OF COST OF SALES REASONABLENESS

	1997	1998	1999	2000	2001	TOTALS
REAL ESTATE SALES (1)	3,241,300.00	7,265,685.00	8,959,806.00	8,631,036.00	9,178,461.00	37,276,288.00
COST OF REAL ESTATE SOLD (2)	2,693,800.00	6,785,827.00	9,398,675.00	9,381,417.00	9,526,748.00	37,786,467.00
CALCULATED PERCENTAGE OF COST TO SALES (3)	83.11%	93.40%	104.90%	108.69%	103.79%	101.37%
PERCENTAGE RECOMMENDED BY NATIONAL ASSOCIATION OF HOMEBUILDERS	85%	85%	85%	85%	85%	85%
PERCENTAGE ABOVE OR BELOW INDUSTRY %	-1.89%	8.40%	19.90%	23.69%	18.79%	16.37%
EXCESS COST OF SALES	($61,305.00)	$609,994.75	$1,782,839.90	$2,045,036.40	$1,725,056.15	$6,101,622.20

SOURCE:
(1) and (2) REVENUE AND EXPENDITURES FROM PHI AUDITED FINANCIAL STATEMENTS
COST OF SALES RATE RECOMMENDED IS National Association of Homebuilder's Industry Average % cost of real estate sold to cost of sales adjusted for non-profit status.
(3) CALCULATED RATE OF COST OF SALES IS ACTUAL COST OF REAL ESTATE SOLD TO ACTUAL REAL ESTATE SALES.

WORK PERFORMED:
COMPARED COST OF REAL ESTATE SOLD TO RECOMMENDED INDUSTRY AVERAGE FOR FIVE YEAR PERIOD FROM 1997 THROUGH 2001 IN ORDER TO DETERMINE REASONABLENESS OF COST OF SALES.

CONCLUSION:
PHI COST OF SALES DATA INDICATE THAT THE COST OF SALES IS EXCESSIVE FOR THE YEARS 1998 THROUGH 2001 WHEN COMPARED TO THE RECOMMENDED PERCENTAGE, 85%, BASED ON NAHB DATA.

FOR THE FIVE YEARS THE TOTAL AMOUNT OF EXCESSIVE COST OF REAL ESTATE SOLD IS $6,101,622. THIS IS AN AVERAGE OF $1,220,324.44 PER YEAR.

PHI'S COST OF SALES INCLUDED FINANCE EXPENSES, THE INDUSTRY RECOMMENDS THIS BE IN OVERHEAD, AND NOT EXCEED 2-2.63%, BUT PHI'S COST FOR FINANCING WAS HIGHER AS THEY HAD TO BORROW TO PAY OFF THE LARGE OVERHEAD THEY INCURRED, AND FOR HOUSES WHICH DID NOT SELL PROMPTLY. ADDITIONALLY, WE FOUND INSTANCES WHERE THE COMPANY CHARGED OFF NOTES AND CLOSING COSTS WHICH EMPLOYEES OWED FOR HOUSES THEY PURCHASED TO COST OF SALES, WHICH INCREASED THE DOLLARS AND PERCENTAGES.

Prepared by Internal Audit
1/9/04

Project Homestead Analytical Review - Analysis of Expense Accounts

Procedure: Auditors examined Project Homestead's income statement from 1996 through 2002 to gain an understanding of which accounts have experienced the most cash flow activity. In doing so, we focused primarily on the expense accounts because these are the accounts showing the company's cash outflows, and therefore show the ways in which Project Homestead has been spending its grant monies and donations. We performed an analytical review of the expense accounts to determine which accounts contain significant dollar amounts and have also experienced drastic increases over the past few years. We used this information in assessing which areas appear to be "high risk areas" that require a more in-depth focus of our attention during our audit.

Auditor's Note: Although the period being audited is 1997 through 2001, we have also included data from years 1996 and 2002 in the analysis below as supplemental information to provide a more complete representation of the changes in these accounts.

	2002	2001	2000	1999	1998	1997	1996	% Change (1996 - 2002)
REVENUES								
Real Estate Sales	9,067,178	9,178,461	8,631,036	8,959,806	7,265,685	3,241,300	2,774,678	226.78%
Cost of Real Estate Sold	(8,094,449)	(9,526,748)	(9,381,417)	(9,398,675)	(6,785,827)	(2,693,800)	(2,449,418)	230.46%
Donated Land Value						(215,254)	(238,750)	-100.00%
Contributions and Grants	1,678,539	2,672,760	2,727,871	2,865,307	2,009,529	824,368	475,737	252.83%
Fees	480,103	616,575	314,666	147,705	173,285	64,164	261,149	83.84%
Rental Income	85,956	44,964	152,064	280,256	508,610	298,005	277,654	-69.04%
Day Care	22,551	(69,118)	(16,870)	77,947	50,813	24,067	(6,369)	-454.07%
Mortgage Services		(44,449)	(18,650)	(4,001)	(2,401)			
Gain on Sale of Property & Equipment	83,866	79,577	(281)			1,962		
Dudley-Lee Center	(857)							
Entrepreneurship and Economic Development Investment, LLC	(100,075)							
Other	41,605	94,472	273,929	266,422	103,724	106,073	40,709	2.20%
Annual Banquet						15,925	53,605	-100.00%
TOTAL REVENUES	3,264,417	3,046,494	2,682,348	3,194,767	3,323,418	1,666,810	1,188,995	174.55%
EXPENSES								
Salaries	953,975	1,149,676	1,172,781	847,862	634,932	518,831	379,943	151.08%
Payroll Taxes	74,586	92,800	93,532	64,976	50,722	42,098	28,456	162.11%
Group Insurance	46,101	41,823	53,939	54,551	24,052	23,923	20,007	130.42%
Vehicle Expenses	80,598	46,641	9,039	4,138	4,308	7,983	8,366	863.40%
Depreciation	104,148	107,634	101,806	100,568	78,359	60,995	43,432	139.80%
Dues and Subscriptions	15,366	3,409	7,108	10,868	3,873	3,834	6,280	144.68%
Utilities	30,368	34,868	24,432	28,116	22,141	8,218	6,292	382.64%
Credit Reports	15,103	10,072	7,263	8,114	5,770	4,225	1,749	763.52%
Direct Assistance	15,184	19,100	15,922	17,805	5,813	12,336	23,223	-34.62%
General Insurance	64,845	84,538	75,336	45,178	59,387	22,145	18,879	243.48%
Interest Expense	146,839	167,870	271,902	304,344	431,470	315,624	246,520	-40.44%
Repairs and Maintenance	114,503	86,741	90,133	74,043	66,027	61,756	17,362	559.50%
Rentals	18,869	6,699	23,772	52,762	52,348	9,430	6,649	183.79%
General Expenses	11,999	15,388	18,185	48,679	39,988	18,251	20,407	-41.20%
Postage	8,507	12,403	10,263	9,006	6,411	4,513	4,154	104.79%
Legal and Accounting	102,903	109,204	113,336	133,697	56,303	59,416	13,464	664.28%
Property Taxes	3,066	9,346	11,002	10,636	12,754	5,149	6,547	-53.17%
Contracted Services	635,920	566,615	186,814	109,031	58,104	41,387	20,891	2943.99%
Printing	18,545	14,961	15,563	16,993	5,677	8,442	20,866	-11.12%
Office Supplies	111,654	104,446	124,601	108,247	56,935	11,290	12,572	788.12%
Telephone	122,018	159,039	95,203	61,164	17,770	15,943	13,823	782.72%
Travel	107,995	178,749	130,404	58,808	12,249	16,209	2,971	3534.97%
Annual Banquet					2,970	28,126	28,424	-100.00%
Miscellaneous	27,470	28,189	36,253	81,210	38,181	27,465	31,217	-12.00%
Rent Expense		16,680						
Advertising	135,696	68,053						
Appraisals, surveys, inspection	3,235	10,098						
Bad Debts	1,794	17,793						
Capitalized Overhead		(100,000)						
TOTAL EXPENSES	2,971,287	3,062,835	2,688,589	2,250,796	1,746,544	1,327,589	982,494	202.42%
REVENUES - EXPENSES	293,130	(16,341)	(6,241)	943,971	1,576,874	339,221	206,501	41.95%
NET ASSETS - BEGINNING OF YEAR	2,550,490	2,566,831	2,573,072	2,781,088	1,204,214	864,993	658,492	287.32%
NET ASSETS - END OF YEAR	2,843,620	2,550,490	2,566,831	3,725,059	2,781,088	1,204,214	864,993	228.74%
Adjustments to Net Assets				1,151,987				

Conclusion: The results of our analytical review highlight five main accounts that are both significant in amount and have also experienced significant increases. These accounts include: legal and accounting expense, contracted services expenses, office supplies expense, telephone expense, and travel expense. As a result, these high-risk areas will be the center of our focus during the performance of our audit.

PREPARED BY INTERNAL AUDIT
11/11/2003

EXHIBIT D

CRUISE & OTHER TRAVEL CHARGES INCURRED

	1997	1998	1999	2000	2001	GRAND TOTALS
Total Cruise & Vacation Related Travel	$12,206.62	$3,813.00	$50,458.42	$23,291.93	$27,952.12	**$117,722.09**
Total Automobile Related Travel	$351.30	$1,486.52	$7,690.42	$10,445.96	$9,140.83	**$29,115.03**
Total Airline Related Travel	$8,562.33	$5,731.72	$24,062.23	$20,671.13	$23,005.25	**$82,032.66**
Total Hotel Related Travel	$1,546.93	$5,893.40	$11,797.53	$13,750.16	$4,945.94	**$37,933.96**
Totals for each Year	**$22,667.18**	**$16,924.64**	**$94,008.60**	**$68,159.18**	**$65,044.14**	**$266,803.74**

Note: The total Personal Travel Charges for all years above is $266,803.74. The items were for charges not associated with the normal operations of the non-profit corporation. No receipts were available to substantiate any relation with the non-profit.

TOTAL PERSONAL CHARGES PER CREDIT CARD

	1997	1998	1999	2000	2001	GRAND TOTALS
First Citizens Bank Card Charges	$35,185.19	$1,311.00	$2,279.45	$2,738.35	$1,255.54	**$42,769.53**
American Express Credit Card		$39,091.36	$143,580.20	$64,791.72		**$247,463.28**
BB&T Credit Card				$70,725.53	$119,403.71	**$190,129.24**
Totals for each Year	**$35,185.19**	**$40,402.36**	**$145,859.65**	**$138,255.60**	**$120,659.25**	**$480,362.05**

Note: The total Credit Card Charges for all years above is $480,362.05. The items were for charges not associated with the normal operations of the non-profit corporation. No receipts were available to substantiate any relation with the non-profit.

Prepared by Internal Audit
1/9/04

City of Greensboro
North Carolina

September 12, 2003

Reverend Michael King, President
Project Homestead, Incorporated
640 Martin Luther King, Jr. Drive
Greensboro, NC 27406

Dear Reverend King;

The City of Greensboro Internal Audit Division will be performing a compliance audit on all Program Income and Project Proceeds generated by Project Homestead's use of Federal, State and Local Funding from the City of Greensboro in all City contracts and programs with Project Homestead for the years ended 1997 through 2001. The CHDO Agreement executed between the City of Greensboro and Project Homestead on April 30, 1999, gives the City the right to monitor the activities and to complete on-site monitoring reviews of Project Homestead's activities every six months as stated under the section "10 Monitoring: A, B, and C on pages 7 & 8" of the agreement. Additional audit terms are specified in the various project agreements that the City has with Project Homestead.

Program Income as defined by HUD is "gross income received by the recipient or subrecipient directly generated from the use of CDBG, HOME, Bond, Housing Partnership Funds and any other funds used to generate program income." *Gross Income* is defined as "income from the use or rental or real property, owned by the recipient or by a subrecipient, that was constructed or improved with CBDG, HOME, Bond, Housing Partnership and any other funds, *less* costs incidental to generation of the income." In order to determine program income and project proceeds, expenses will be examined to determine how the income and proceeds were calculated.

The Audit Division will review all documentation necessary to determine that funding from the programs/contracts provided for in our agreements is being used as designated and any income/proceeds generated is used to further the goals provided for in the contracts/programs within the Greensboro area. The documentation needed includes but is not limited to: closing statements; deeds of trust; incomes of clients; credit reports; building permits; construction costs; invoices; land costs; overhead schedules; payroll schedules; general ledgers; purchase money notes; home ownership counseling documents and any other information as requested.

We plan to commence the audit on September 22, 2003. Additionally, we would like to conduct an entrance meeting on September 15, 2003 to discuss the conduct of the audit. If you have any questions concerning the audit, please contact me at 373-2821.

Sincerely,

Len Lucas
Acting Internal Audit Director

Cc: Ed Kitchen, City Manager
Ben Brown, Assistant City Manager for Economic Development
Mitchell Johnson, Assistant City Manager
Bob Morgan, Assistant City Manager
Linda Miles, City Attorney
Andy Scott, Director of Housing & Community Development
Dr. Alton Thompson, Chairman of Board of Directors for Project Homestead, Inc.