



OFFICE OF THE COMPTROLLER
CITY OF ST. LOUIS



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December 17, 2007

Gary Johnson, Director
Minority Developers and Builders Association
1420 North Vandeventer
St. Louis, MO 63113

RE: Fiscal Monitoring Report of Minority Developers and Builders Association, LLC
(Project # 2007-AHC19)

Dear Mr. Johnson:

Enclosed is a report of our fiscal monitoring review of Minority Developers and Builder's Association, LLC (Document #51937) for the period September 1, 2005 through July 31, 2007. The scope of a fiscal monitoring review is substantially less than an audit and, as such, we do not express an opinion on the financial operations of Minority Developers and Builders Association. Our fieldwork was completed on July 26, 2007.

This review was made under authorization contained in Section 2, Article XV of the Charter, City of St. Louis, as revised and has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and through an agreement with the Affordable Housing Commission to provide fiscal monitoring to all grant subrecipients. If you have any questions, please contact Ishmael Ikpeama at 589-6113.

Sincerely,

Sedrick D. Blake, MBA, CPA
Audit/Fiscal Executive

Enclosure

cc: Angela Morton Conley, Executive Director, Affordable Housing Commission



CITY OF ST. LOUIS

AFFORDABLE HOUSING COMMISSION

*MINORITY DEVELOPERS AND BUILDERS, LLC
DOCUMENT #51937
CONTRACT #25-05SL*

FISCAL MONITORING REVIEW

SEPTEMBER 27, 2005 THROUGH NOVEMBER 30, 2007

PROJECT #2007-AHC19

DATE ISSUED December 17, 2007

*Prepared by:
The Internal Audit Section*



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HONORABLE DARLENE GREEN, COMPTROLLER

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INTRODUCTION

Background

Contract Name: Minority Developers and Builders Association, LLC

Document Number: 51937

Contract Number: 25-05SL

Contract Period: March 1, 2005 through March 1, 2006

Contract Amount: \$200,000

This contract provided funds to Minority Developers and Builders Association, LLC (Agency) to construct homes (Bosley Estates) in the Hyde Park area of the City of St. Louis to enhance and support community development activities by expanding the housing stock with decent, safe, and sanitary living environments. The source of the funds provided to the Agency through Affordable Housing Commission (AHC) is the City's share of sales and use tax collections. The newly constructed homes are offered at affordable prices for sale to certain individuals or families with annual incomes that do not exceed 80% of the median family income for the St. Louis City area.

Purpose

The purpose of this fiscal monitoring review was to determine the Agency's (Document #51937) compliance with the terms and conditions of its contract with Affordable Housing Commission (AHC) and make recommendations for improvements, if necessary.

Scope and Methodology

We made inquiries regarding the Agency's internal controls relating to the grant administered by AHC, tested evidence supporting the reports the agency submitted to AHC and performed other procedures considered necessary. Our fieldwork was completed on July 26, 2007.

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CONCLUSION AND SUMMARY OF OBSERVATIONS

Conclusion

The Agency did not fully comply with the terms and conditions of the contract (see observation in the “Summary of Current Observations” below).

In a letter dated October 22, 2007, the agency’s management stated it would be ready to meet Internal Audit staff by November 26, 2007 to respond to the information originally requested July 18, 2007. We did not receive a response from the agency on that date. Internal Audit notified the agency in a letter dated November 26, 2007 that if the agency did not provide responses and the information that we requested originally within ten (10) business days from the date of the letter, we would issue our report prepared from documentation the agency submitted to AHC and received reimbursements. As of the date of this report, we have not received management response from the agency.

Status of Prior Observations

This is the first fiscal monitoring review for the Agency. Hence, there were no prior observations. However, we noted the City’s Community Development Administration (CDA) did provide federal funds to the owner of the Agency, Mr. Johnson, on many projects in the past. CDA, however, finally cut-off the funding because on those projects it faced similar problems to the ones noted in the “Detailed Observations, Recommendations and Management’s Responses” section of this report.

Summary of Current Observations

We made recommendations for the following observation which, if implemented, could assist the Agency in fully complying with the terms and conditions of the Affordable Housing Commission’s contract with the Agency:

- Agency’s ability to continue as a going concern.

This observation is discussed in more detail in the *Detailed Observations, Recommendations and Management’s Responses* section of this report.

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Agency's ability to continue as a going concern.

Going concern refers to the Agency's ability to function without the intent or threat of liquidation. It is based on the Agency's ability to realize assets and discharge liabilities during the normal course of business. Based upon the observations noted below, there is serious doubt about the Agency's ability to continue as a going concern:

A. Permanent business address

During our planning for the review, we noted various business addresses listed on documents submitted by the Agency. Since our first attempt on June 21, 2007 to contact the Agency and begin the review, we have not been able to contact the Agency to discuss the review procedures. The address on file and noted in the contract is no longer associated with the Agency, and the City's website for St. Louis Development Activity noted a completely different address.

On Wednesday July 18, 2007, we were provided business phone and fax numbers to fax a list of items required for the review. On Monday, July 23, 2007, when we dialed the business phone number, the message stated, "You have reached a number that has been disconnected or is no longer in service". On August 6, 2007, the Agency contacted IAS and we informed them the numbers did not work. The Agency's secretary stated the director did not remember the numbers correctly and provided numbers to the old office location when the Agency was in the process of setting up at a new office. We have not been provided a business address for the new office.

Without an established business address, AHC's ability to meet, discuss and clarify contract expectations and monitor compliance with the terms and conditions of the contract with AHC is adversely affected. In addition, we have not been unable to conduct an entrance conference with the Agency to explain the review process and obtain the necessary documentation to resolve the issues raised by AHC and homeowners during our review.

B. Problematic issues with the project

Due to the lack of a permanent address, we were unable to meet with the Agency to discuss the agency's accounting system, review policies and procedures, and the

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accounting records. Instead, we reviewed documentation on file and financial records the Agency submitted to AHC. These records included Pay-request worksheets,

B. (Continued...)

applications for certificate for payment, agreements with the eligible homebuyers, Agency's affidavits and requisitions for funds, and waivers for lien labor and materials. We noted the following inadequacies in the documents submitted by the Agency:

- A 10-day lien was filed on the first four homes. The title company informed AHC that it did not even have the invoice on which the lien was based. The Agency subsequently paid the subcontractor. However, this raised concerns that the Agency was not providing all invoices to the title company and other liens could be pending.
- According to disbursement agreement (a supplement to the contract between AHC and the Agency), each draw request is to be strictly comprised of 71% bank funds and 29% AHC funds based on the following total project amounts:

Construction to be financed by AHC	\$ 200,000
Construction to be financed by private loan	<u>490,000</u>
Total project amount	<u>\$ 690,000</u>

Each request for payment given by disbursing agent (Title Company) to the lenders shall reflect the total amount requested by Agency and the amount to be drawn from each of the loans in accordance with the foregoing percentages. Despite being forewarned of the City's document execution and fund disbursement requirements, the Agency requested the AHC funds only after it has largely expended the private loan. As a result, the Agency has disproportionately used bank money to fund construction. AHC has released funds solely and heavily to reduce the disproportionate amount of bank funds that went into the project.

C. Inadequate accounting records

An adequate accounting system ensures timely preparation of financial information that is complete, free from obvious errors and misstatements.

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C. (Continued...)

We noted the following inadequacies:

- Paperwork (requests for payment lien waivers, deeds of trust and other documents as requested by AHC) was not submitted timely and contained wrong or contradictory information with an abundance of errors and misstatements. This was despite AHC's Housing Analyst efforts to show the Agency director how to complete Requests for Payment and Lien Waivers correctly.
- Incorrect addresses were drafted into the legal documents. The Agency's director made corrections after originally signing the documents, but before AHC's execution of the legal documents.
- The Agency's director delayed providing AHC signed legal documents (deeds of trusts, architect certificate, etc.) and the required due diligence during construction of the first four homes.
- The Agency's director and officer were required to co-sign on the transfer of two properties. However, the other officer initially refused to co-sign and the transfer could not be recorded. On May 30, 2006, the other officer finally co-signed but AHC has not received written documentation verifying this.

D. Opportunity to improve documentation of expenditures

The Agency's agreement with AHC requires the Agency to provide a Detailed Cost Breakdown (total acquisition and development cost of project). We were unable to meet with the Agency to discuss the agency's procedures for documenting, recording, approving expenditures, and requesting reimbursement from AHC. Instead, we reviewed documentation on file at AHC for expenditures that had been reimbursed. The support documentation for reimbursed expenditures included the following as prepared and submitted by the Agency:

- Waiver of Lien for Labor & Material Costs
- Waiver of Lien & Agreement,
- Application and Certification for Payment
- General Contractor Affidavit and
- Developer (Agency) Payment Request Worksheet

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D. (Continued...)

We observed the following deficiencies with the documentation for expenditures submitted for reimbursement:

- The waivers of lien for labor & material costs were signed by an individual who is the owner of the subcontracting company (Johnson Contracting) and the Agency. This causes an appearance of a conflict of interest.
- The Payment Request Worksheet was not detailed, and often consists of only a one line item lump-sum request for payment. There were no timesheets or a breakdown of how much of the requested payment amount was for labor and how much was for construction materials. Without detailed support documentation, labor and construction materials may not be properly charged to the project and reimbursed.

E. Opportunity to improve client eligibility documentation.

The Agency's contract agreement with AHC contract requires that the newly developed homes are sold to qualified purchasers (individuals or families) with annual incomes which do not exceed 80% of the median family income for the area. Adjustments may be made for smaller and larger families. We noted the purchaser for the third home did not have adequate proof of his/her income eligibility.

In addition, we were informed that financing for the third purchaser fell through and the purchaser subsequently secured financing with another title company and expects to complete closing August 2007. AHC remains unaware whether the purchaser of the third home would be able to complete closing (*see note below*). The fourth home was still under construction at the time of this report

Without proper documentation of client's eligibility and income verification, the funds may not be administered to the families intended by the contract agreement. In addition, AHC noted when closing on sale of a home is started and then delayed, AHC loses interest on the \$10,000 subsidy that is disbursed to assist the homebuyer in purchasing a home.

Note:

We obtained documentation from the Recorder of Deeds Office and noted the purchaser of the third home completed closing on October 19, 2007.

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F. Failure to provide required tax forms.

The Agency's agreement with AHC requires the Agency to file all federal, state and local tax returns and other reports as required. We were unable to meet with the Agency to discuss the Agency's tax filing status and obtain the Agency's copies of tax records. Instead, we reviewed AHC files and determined the Agency's Tax verification form was originally rejected and requested the Agency to complete two additional forms (AP and E9). Subsequently, the Agency did receive tax clearance from the Collector of Revenue for approval of Earnings Tax and Personal Property Tax.

We were unable to verify the Agency's tax filing status and determine if the proper returns were filed (990 for Non-Profit Tax Exempt Organization, 1120S for Limited Liability Corporation, or 1065 for Partnership). Also, we were not provided documentation that the Agency had been issued a State of Missouri Sales Tax Exemption letter.

G. Failure to comply with rules, regulations and overall specifics of construction agreement.

Our review of the Agency's agreement with AHC and an AHC summary of the project revealed that the Agency did not comply with several rules, regulations and overall specifics of the contract agreement. The summary noted the following:

- Deed of Trust was not recorded or returned to AHC.
- Despite being informed of the City's document execution and fund disbursement requirements, the Agency delayed providing legal documents to AHC.
- An Alderman frequently contacts AHC on behalf of the Agency when the Agency is unhappy with AHC's response because AHC will not allow circumvention of established rules and agreements.
- Homes were to be constructed in a universal design (UD) with accessible bedroom and bathroom on the stepless level of the homes. However, bathrooms in the first four constructed homes are not wheelchair accessible.

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G. (Continued...)

- Agency did not adhere to all contract specifications for sections of the agreement such as:
 - Conditions of Closing – Detailed cost breakdown, developer's organizational document which evidence the developer is authorized to do business and is good standing.
 - Developer Responsibilities – Supervision of project, the qualifications, financial condition and performance of architects, engineers, subcontractors and suppliers, quality and suitability of materials and workmanship on the project.
 - Disbursement of Loan Proceeds – Advances of the loan to be disbursed pro rata, 71% bank and 29% AHC subsidy, with the proceeds of construction loan and in strict compliance with the detailed cost breakdown, advances are disbursed only after the Agency's equity has been expended for the project and only for work completed.
 - Covenants of Developer – Construction of the project using first-class materials in a good substantial workmanlike manner in accordance with plans and specifications, construction shall be completed free and clear of all claims or liens for labor, materials and supplies, maintain proper books of record and account in accordance with generally accepted accounting principles.
 - Contractor's Defaults – Events of Default shall be cured in 30 days of notification or additional 45 days if diligently and continuously attempting to cure. Cures shall have prior written consent from AHC in the event the parties directly or indirectly comprising the developer are dissolved, terminated or liquidated or merged into another entity. Deviations in construction of project from plans and specifications previously approved by AHC or defective materials and workmanship and are not cured within 45 days will be considered a default.

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G. (Continued...)

- The purchaser of the second home has filed a complaint with the Agency and AHC regarding construction defects in her home. Items in the complaint include cracked concrete in the patio and driveway, defects in the siding on the porch and side of the house, nails in the flooring, door locks, light switches and phone jacks were not properly installed and working. These are clear violations of the Covenants of Agency and Events of Default sections of the contract noted above. As of the date of this report, AHC has not received documentation that the homeowner's complaints have been resolved satisfactorily.

Recommendation

We recommend AHC stop funding the Agency with immediate effect and conduct an extensive investigation into the activities of the Agency to ensure that all AHC funds that were not utilized by the Agency in accordance with the terms and conditions of the AHC contract are repaid to AHC. In addition, any future funding to the Agency should be dependent upon the satisfactory resolution of all the issues raised in this report as follows:

- Provide evidence of a permanent business address and respond to all the issues raised by AHC.
- Establish an adequate accounting system to ensure that the accurate required accounting and legal information are submitted to AHC in a timely manner.
- Comply with the terms and conditions of the contract with AHC.
- Ensure that subcontractors who provided material and services on the project only sign the waiver forms. (The forms that are duly signed by the subcontractors only should replace all waiver forms that were signed by both the Developer and the subcontractor.)
- Complete Payment Request Worksheet with more detailed cost breakdown of the construction labor hours and construction materials used for the project. Timesheets for hours worked at the construction site and invoices for construction materials used should be attached to the payment request.

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Recommendation (Continued...)

- The newly constructed affordable homes are sold to purchasers who meet the income eligibility requirements. Submit to AHC purchaser's proper income eligibility documentation, including income tax return or recent W-2 from the purchaser's employer and other relevant documents for all purchasers of home under this program. If closing on the sale of a home has been delayed, AHC subsidies should be returned to AHC until financing is re-established.

- Resolve all the complaints filed by the homeowners who purchased homes under this program.