MEMORANDUM

To: Audit Committee

From: Mary Hom
                Chief Risk Officer

Date: September 28, 2021

Re: Internal Audit Reports

Since the last report to the Audit Committee on June 2, 2021, two internal audits were completed. A copy of each report is attached, and a summary is as follows:

2021 Reserve for Replacement
Objective:
Our primary audit objectives were:
- To determine the adequacy and effectiveness of control over the HDC Reserve for Replacement (R4R) process;
- To determine compliance with HDC Asset Management R4R request for payment guidelines and the payment disbursement process, and ensuring that relevant documentation is saved in the project folder;
- To determine if the R4R process is properly tracked and monitored by the department head; and
- To determine the accuracy of the R4R payment amount, and ensure the payment was accurately recorded in the General Ledger (GL).

Audit Results:
Upon completion of the audit, we noted no matters involving internal controls that we considered material weakness. We found that key aspects of the R4R guidelines were followed, and that project requests for reimbursement were properly submitted, documented, and accurately recorded in the project GL accounts. While guidelines for processing R4R requests exist, we recommended that a checklist be developed to help guide the process, and that staff training be enhanced to ensure consistent application of the R4R process. Management has indicated that they have begun to work on implementing these recommendations.

2021 Portfolio Inspections
Objective:

Our primary audit objectives were:
- To determine compliance with the Corporation's policies and procedures relating to the timely completion of required annual physical inspections (API) for projects financed by HDC;
- To assess the accuracy of Asset Management's portfolio of properties required for inspections; and
- To evaluate completeness of Engineers' APIs for properties reviewed as part of this audit.

<u>Audit Results:</u>
Upon completion of the audit, we noted no matters involving internal controls that we considered material weaknesses. APIs that were reviewed as part of this audit were accurate, properly assigned, and performed on a timely basis. While guidelines exist for property inspections, we recommend development of a comprehensive policy and procedure document that provides guidance to staff on their responsibilities and establishes criteria for when an API is or is not required. Management is in agreement with this recommendation and will work to assemble this document in the near-term.

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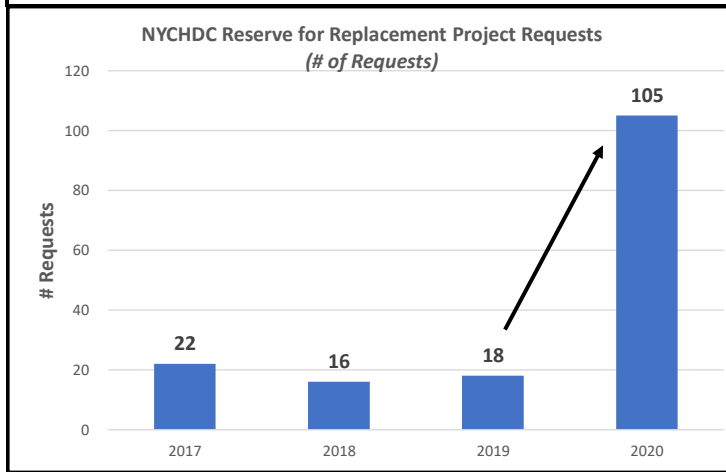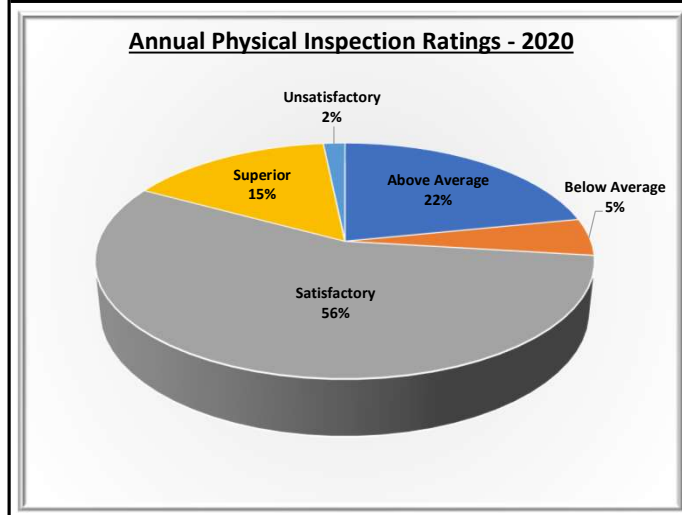|	
Objective:	1. To determine the adequacy and effectiveness of control over the HDC Reserve for Replacement ("R4R") process
	2. To determine compliance with HDC Asset Management R4R Request for Payment Guidelines and the payment disbursement process, and ensuring that relevant documentation is saved in the project folder
	3. To determine if the R4R process is properly tracked and monitored by the department head
	4. To determine the accuracy of the R4R payment amount, and ensure it was accurately recorded in the General Ledger ("GL")
	5 To determine if the project maintained a balance of $1,000 per dwelling unit in the R4R fund at all times
Scope:	Audit scope covered R4R activities from January 1, 2019 to December 31, 2020.
Background:	HDC maintains a Reserve for Replacement ("R4R") escrow account for projects financed by the Corporation's housing programs. The R4R fund is generally used to fund the replacement of building capital items, as well as major repairs that are not considered routine in nature, to help ensure that the physical life of the buildings and structures will extend through the economic life of the project. The reserve is funded by initial collection at loan closing and monthly escrow payment to the fund. The Asset Management Portfolio Analysis unit is responsible for managing the reserve fund; they provide the R4R guidelines to assist owners and managing agents to determine eligible expense items and the required documentation necessary to support a request for disbursement from the fund. The Portfolio Analysis unit is also responsible for the evaluation, processing, and approval of all Replacement Reserve disbursement requests, and ensuring that sufficient funds are maintained in the project's escrow fund account, while the Asset Management Engineering department is responsible for inspecting the work and approving final payment amounts. The project's regulatory agreement requires that only items listed on the eligible list qualify for approval of disbursements from the R4R account. Unless otherwise specified by HDC Asset Management, a balance of $1,000 per dwelling unit must be maintained in the R4R account at all times, and reimbursement requests must be made within two years after the date the work was performed.
Results:	**Upon completion of the audit, we noted no matters involving internal controls that we considered material weakness. We found the following:** •**Key aspects of the R4R guidelines were followed** •**Project requests for reimbursement were properly submitted with required documents** •**The Engineer review, inspection, and final payment approval were properly documented** •**Fund transfer payment "Form 9250" were accurately completed and sent to Cash Management for payment disbursement to the project** •**Payments to project are accurately recorded in the project GL accounts**
Recommendations:	While there was a document outlining guidelines, a formal policy and procedure document should be developed that builds off the guidelines. This document should outline the policy for R4R requests, guidelines for processing R4R requests, and procedures to follow to examine and approve any exceptions to the policy. In addition, the policy should be dated and reviewed periodically. Organizational procedures evolve over time due to technology updates, personnel changes, and other considerations; the procedure manual should keep up-to-date with these changes. Moreover, adding a date to a procedure document ensures that employees are aware of the relevance of the procedures they are following.

NYCHDC Reserve for Replacement Project Requests
(# of Requests)

Year	# Requests
2017	22
2018	16
2019	18
2020	105

Internal Controls:
- ✓ Segregation of Duties
- ✓ HDC R4R Request for Payment Guidelines
- ✓ Portfolio Analysis Manual
- ✓ List of Eligible Items for Reimbursement
- ✓ Each item of work over $10,000 must have three bids
- ✓ Portfolio Analysis reviews project requests and routing slips
- ✓ Engineering & Inspection team completes Final Approval Worksheet
- ✓ R4R Payment Release Form 9250 to Cash Management
- ✓ Supervisor R4R Request Monitoring and Tracking Spreadsheet

Staff Functions /Responsibilities for R4R Process:
- ▪ 1 VP
- ▪ 1 Senior Portfolio Analyst
- ▪ 3 Staff Portfolio Analysts
- ▪ Engineering division (inspections)
- ▪ Cash Management (fund transfers to project)

*Explanation for the 480% increase in R4R requests in 2020 versus 2019:
- ▪ Many projects requested reimbursement for major elevator door monitoring system upgrades in order to comply with the NYC Dept of Building code, Appendix K, Chapter K3, Section 3.10.12. Compliance deadline was January 1, 2020; and
- ▪ To replenish unexpected expenses made from the operating account and maintain project cash flow during COVID-19 pandemic lock down

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Objective:	1. To determine compliance with the Corporation's policies and procedures relating to the timely completion of required annual physical inspections for projects financed by HDC 2. To assess the accuracy of Asset Management's portfolio of properties required for inspections 3. To evaluate completeness of Engineers API's for properties reviewed as part of this audit
Scope:	Audit scope covered Annual Property Inspections from January 1, 2020 to December 31, 2020.
Background:	Projects financed by HDC require an annual property inspection to be performed. These inspections must be of a sufficient quality to ensure an accurate evaluation of the condition of the property and that it is maintained in a decent, safe, and sanitary condition, and in good repair. The Engineering and Architectural division is assigned to perform these inspections, and coordinates schedules with managing agents to ensure the required annual physical inspection is completed within the year. The engineers provide a written report, named the Annual Physical Inspection (API) report, to the borrower and the managing agent within thirty days of the inspection. The report lists any deficiencies noted during the inspection and provides an overall rating of either 'Superior', 'Above Average', 'Satisfactory', 'Below Average or 'Unsatisfactory' for both physical conditions and maintenance. The borrower is expected to provide a written response within thirty days describing how and when deficiencies noted in the report will be corrected.
Results:	**Upon completion of the audit, we noted no matters involving internal controls that we considered material weaknesses. Opportunities exist to further enhance controls for the Annual Property Inspection (API) process. This would include drafting a comprehensive policy and procedure document that provides guidance to staff on their responsibilities, and policies which establish criteria for when an API is/is not required. Other than the observation noted in this report, API's which were reviewed as part of this audit were accurate, properly assigned, and done timely.**

Recommendations:
1. Develop comprehensive written policies and procedures that establish responsibilities for the API process. Policies should include but not be limited to the following:
i. Identifying and reconciling projects requiring an inspection
ii. Scheduling
iii. Performance of inspections
iv. Documenting inspection results
v. Review and approval requirements
vi. Notification requirements
vii. Recordkeeping

Enhancement Opportunities:
1. Standardize schedules for Engineer activities by developing a naming convention/coding when maintaining schedules for API's.
2. Implement Adobe Sign to ensure authorized digital signatures are recorded when API's are reviewed and approved.
3. Implement a monthly reconciliation process to keep track of all projects inspected or to be inspected for the year.
4. Develop a risk based inspection schedule to streamline schedules based on property and tenant characteristics.

Annual Physical Inspection Ratings - 2020

Unsatisfactory 2%
Superior 15%
Above Average 22%
Below Average 5%
Satisfactory 56%

2020 Portfolio Inspection Highlights

Total Number of Portfolio Inspections	610
Total Number of Inspectors/Engineers	6
Average Number of Inspections Per Engineer	102
Highest Month of Performed Inspections	February (90)
Lowest Month of Performed Inspections	November (8)
Average Monthly Performed Inspections	51