AUG 22 2002

CIN: A-04-02-00010

James R. Grace
Executive Director
East Winston Community Development Corporation
1225 East Fifth Street
Winston-Salem, North Carolina 27101

Dear Mr. Grace:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General, Office of Audit Services' final report entitled, Results of Review – East Winston Community Development Corporation's Administration of Office of Community Services Discretionary Grant No. 90EE0353/01. This review covered the period September 1998 through January 2002. A copy of this report will be forwarded to the action official noted on page 2 of this letter for his/her review and any action deemed necessary.

Final determinations as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (see 45 Code of Federal Regulations Part 5).

To facilitate identification, please refer to Common Identification Number (CIN) A-04-02-00010 in all correspondence relating to this report.

Sincerely yours,

Charles J. Curtis
Regional Inspector General
for Audit Services, Region IV

Enclosures - as stated
Direct Reply to HHS Action Official:

Director
Division of Financial Integrity
Room 702 Aerospace Building
370 L'Enfant Promenade, S.W.
Washington D.C. 20447
Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF EAST WINSTON
COMMUNITY DEVELOPMENT
 CORPORATION'S ADMINISTRATION OF
OFFICE OF COMMUNITY SERVICES
DISCRETIONARY GRANT
NO. 90EE0353/01

JANET REHNQUIST
Inspector General

AUGUST 2002
A-04-02-00010
NOTICES

THIS REPORT IS AVAILABLE TO THE PUBLIC
at http://oig.hhs.gov

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services, reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Final determination on these matters will be made by authorized officials of the HHS divisions.
August 22, 2002

To: Clarence Carter, Director
Office of Community Services

From: Regional Inspector General for Audit Services, Region IV

Subject: Review of East Winston Community Development Corporation’s Administration of Office of Community Services’ Discretionary Grant No. 90EE0353/01 (A-04-02-00010)

This final report provides you with the results of our limited-scope review requested by the Department of Health and Human Services’ (HHS) Office of Community Services (OCS) of the East Winston Community Development Corporation’s (EWCDC) administration of OCS Discretionary Grant No. 90EE0353/01.

OBJECTIVE

The objective of our limited-scope review was to determine how EWCDC expended grant funds and if EWCDC complied with the terms and conditions of the grant.

SUMMARY OF FINDINGS

We found that EWCDC did not expend OCS grant funds to renovate the proposed cafeteria site and did not purchase equipment for the cafeteria’s operation as outlined in its OCS-approved grant proposal. We are recommending that OCS recover the $250,000 of grant funds and that OCS assure that EWCDC evaluates its ability to properly control and account for federal funds before submitting future HHS grant proposals. In written comments to the draft report, EWCDC officials disagreed with our findings and recommendations, except the recommendation that EWCDC evaluate its ability to properly control and account for federal funds before submitting future HHS grant proposals. Primarily, the EWCDC officials did not agree that the expenditure of OCS grant funds was restricted for use in renovating the proposed cafeteria site and purchasing equipment for the cafeteria’s operation. The EWCDC officials believed that it was proper to expend the grant funds for any purpose that was related to the overall cafeteria project. The EWCDC comments and the Office of Inspector General’s (OIG) response to those comments are summarized after each applicable side-caption in the FINDINGS AND RECOMMENDATIONS section of this report. The EWCDC’s comments, except the Exhibits, are included as an Appendix. Because of their volume, the Exhibits that accompanied the comments are not included in the report, but are available upon request.
BACKGROUND

The EWCDC is a nonprofit community development corporation established in 1988 to revitalize Forsyth County, North Carolina’s low to moderate-income neighborhoods. On May 18, 1998, EWCDC applied for an OCS grant under OCS’ Priority Area 1.4, Urban and Rural Community Economic Development – Developmental Set-Aside. In its application, EWCDC stated that the purpose of the grant was to create a community-owned, cafeteria-style restaurant known as the EastSide Cafeteria Project. According to the grant application, the EastSide Cafeteria was to be owned by the EWCDC and the Ministers Conference of Winston-Salem and Vicinity. The EWCDC and the Ministers Conference formed David Capital, Inc., a for-profit corporation, to hire management and operations staff for the cafeteria project. David Capital was incorporated on September 9, 1998.

The OCS funds were to be used for equipment purchases and leasehold improvements to an existing site in the East Winston Shopping Center. In addition, EWCDC said in its grant application that it anticipated the project would create 30 full-time equivalent jobs for the community. In the grant application, EWCDC proposed a staff of six, plus seven volunteers to carry out the project. The six proposed EWCDC staff were the Executive Director, Office Administrator, Housing Director, Housing Counselor, Housing Counseling Intake/Administrative Assistant, and Information Systems Manager.

According to the organizational chart provided to us, there were four employees in place at EWCDC at one time: the Executive Director, Administrative Assistant, Housing Coordinator, and Property Manager. Only the Executive Director and the Administrative Assistant currently work on the cafeteria project.

The EWCDC estimated the total project costs at about $1.2 million from the following sources:

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCS Grant</td>
<td>$ 250,000</td>
</tr>
<tr>
<td>NCCD Initiative</td>
<td>200,000</td>
</tr>
<tr>
<td>EWCDC Equity – Grants, Churches, Private Donations</td>
<td>250,000</td>
</tr>
<tr>
<td>Bank Loan</td>
<td>241,500</td>
</tr>
<tr>
<td>City of Winston-Salem</td>
<td>250,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,191,500</strong></td>
</tr>
</tbody>
</table>

On September 18, 1998, OCS awarded EWCDC a $250,000 grant to fund a portion of the cost of the cafeteria renovation ($73,000) and purchase some of the equipment ($177,000) for the cafeteria’s operation. The grant period was September 30, 1998 through September 29, 2003.
OBJECTIVE, SCOPE AND METHODOLOGY

Objective

The objective of our limited-scope review was to determine how EWCDC expended grant funds and if EWCDC complied with the terms and conditions of the grant.

Scope


Our review was performed at the offices of the EWCDC in Winston-Salem, North Carolina from February 11, 2002 through March 8, 2002, and fieldwork continued in the Raleigh Field Office through April 5, 2002. We did not rely on EWCDC’s internal controls during our review. An adequate internal control structure does not exist for reliance thereon because of the small size of the auditee. Therefore, we completed our objectives through substantive testing.

On May 15, 2002, we issued a draft report to EWCDC officials and requested that they provide us with written comments. On June 6, 2002, EWCDC requested an extension of time to provide written comments. We extended EWCDC’s due date for written comments to July 8, 2002. On July 8, 2002, we received EWCDC’s written comments.

We conducted our review in accordance with generally accepted government auditing standards.

Methodology

To accomplish the objectives of our limited-scope review, we:

- reviewed documents from the North Carolina Secretary of State’s office to determine if David Capital, Inc., EWCDC, and Millennium Group Development, LLC were in good standing as legal entities in the state;

- reviewed the stock subscriptions/receipts books from David Capital and identified stock owned by EWCDC. We obtained David Capital stock certificates issued to EWCDC. We also obtained cancelled checks from EWCDC to David Capital for stock purchases. We held discussions with the Executive Director concerning the transactions. The stock subscription forms were for stock purchases during the periods January, February and October 1999;

- reviewed available minutes from the EWCDC and David Capital Boards of Directors meetings from January 8, 1998 to August 21, 2001 and examined the EWCDC Board’s role in administering the grant;
reviewed EWCDC’s most recent independent audit report for the year ended December 31, 1997 and determined from a discussion with the Executive Director that there have been no audits performed since this date;

examined invoices and cancelled checks from the six EWCDC and David Capital bank accounts to determine the extent of accountability for OCS funds and funds from the sale of David Capital stock;

identified the sources and amount of funds EWCDC raised for the cafeteria project;

reviewed EWCDC’s cash draw downs of grant funds, determined the receipts and disbursements to and from the six bank accounts, and determined the balances of cash on hand in these six accounts;

did not test any procurement procedures or inventory records because there were no cafeteria-related inventory items to review. However, we did review the landscape, architecture, and design services contract between David Capital and the Millennium Group Development, LLC; and

determined if EWCDC made any major unapproved programmatic or budget changes.

On April 10, 2002, we met with EWCDC officials to discuss our preliminary findings and recommendations.

FINDINGS AND RECOMMENDATIONS

The EWCDC did not expend OCS grant funds to renovate the proposed cafeteria site and purchase equipment for the cafeteria’s operation as outlined in its grant proposal that OCS approved.

Ownership Interest and Legal Entities

The EWCDC had a 62 percent ownership interest in its for-profit subsidiary, David Capital, Inc. Individual stockholders own the remaining 38 percent. Records at the North Carolina Secretary of State’s office showed that EWCDC, David Capital, and Millennium Group Development, LLC were in good standing as legal entities in the State of North Carolina.

Stock Purchase

The EWCDC used $150,000 of the $250,000 of OCS grant funds to purchase stock in David Capital. The remaining $100,000 was co-mingled with EWCDC funds.
The EWCDC wrote four checks totaling $150,000 to purchase David Capital stock. All four checks were dated January 26, 1999. Even though the checks bore the same date, they were written for different amounts. The first and fourth checks were for $50,000 each and the second and third checks were for $25,000 each. The first check was written to David Capital for $50,000. The second check was written to Victory-Masonic Credit Union for $25,000. The third check was written to BB&T Bank for $25,000, and the fourth check was written to Wachovia Bank for $50,000. All checks, except the first, were written to the banks in order to open new accounts for David Capital. The first check was deposited in an already existing David Capital account with Mechanics and Farmers Bank. We asked the Executive Director why EWCDC did not write just one check for the stock rather than four. The Executive Director said that three of the four checks were written to open new bank accounts for David Capital. By opening these new accounts, it was hoped that a relationship could be established with the financial institutions that would result in the institutions providing some financial support for the cafeteria project. However, as discussed later in this report, these relationships did not result in additional project funding.

Third-Party Agreement

The Federal Register, Volume 61, No. 72, dated April 12, 1996, requires a third-party agreement for applicants that propose to use OCS funds to purchase stock in a business concern, including a wholly-owned subsidiary. The EWCDC did have a third party agreement as described in the OCS grant program announcement. However, EWCDC’s grant application did not show that EWCDC planned to purchase David Capital stock with grant funds. The grant application stated that EWCDC formed David Capital to hire management and operations staff for the cafeteria project. No mention was made in the grant application of an equity investment in David Capital using OCS funds.

At the November 23, 1998 David Capital Board meeting, the EWCDC’s Board Chairperson acknowledged that EWCDC had drawn down OCS grant funds to provide David Capital with operating funds through the purchase of 20,000 shares of David Capital stock. The EWCDC’s semiannual progress report to OCS, dated October 26, 1999, was the first written indication to OCS that EWCDC had used grant funds to purchase David Capital stock. The EWCDC stated in this progress report that, “…East Winston CDC has purchased 24,900 shares initially, which will insure the continuation on (sic) the project (CDC left $1,000 in the account, but have (sic) drawn it down to purchase another 100 shares, which make (sic) a total to (sic) 25,000 shares)….”. We found no evidence that EWCDC had requested or OCS had granted approval to use grant funds to purchase David Capital stock.

In a March 29, 1999 letter to the Director of OCS, the EWCDC Board Chairperson requested a meeting “. . .to discuss possible changes to [EWCDC’s] initial application. . .” However, we found no evidence that EWCDC had specifically requested or OCS had granted approval to use grant funds to purchase David Capital stock.
EWCDC Comments

In their written comments, EWCDC officials said that OCS knew from the May 1998 grant application that grant proceeds would be used to purchase stock in David Capital. The EWCDC officials further asserted that OCS’ knowledge of the details of the stock purchase constitutes tacit approval, if not actual written approval of the use of grant funds to buy the stock.

The EWCDC officials also said that they did not understand how the draft report reached the conclusion that it did in regard to the functions of David Capital. The EWCDC officials opined that the David Capital Articles of Incorporation state the functions for which David Capital was formed; to wit “…(i) to promote community development of the area….and (ii) such other purposes as are permitted for general business corporations”.

OIG Response

We disagree that OCS gave EWCDC prior approval to use grant funds to buy stock. The grant’s prior approval requirements are delineated in 45 Code of Federal Regulations (CFR) Part 74, Section 74.25, entitled Revision of Budget and Program Plans. Section 74.25 (a) states that the grant budget plan is the financial expression of a project or program as approved during the award process. Section 74.25 (b) and (c) contains the requirements relative to grantees reporting deviations from budget and program plans and requesting prior approvals for budget and program plan revisions. Section 74.25 (c) (1) contains the requirement for prior approval in cases where there is a change in the scope or objective of the project even if there is no associated budget revision requiring prior written approval. Section 74.25 (k) further states that all approvals granted under Section 74.25 are not valid unless they are in writing and signed by the appropriate HHS official. Thus, OCS’ knowledge of an action does not constitute prior written approval of the action.

Our conclusion regarding the functions of David Capital was based on EWCDC’s grant application. Page 13 of the application states in part, “…A for-profit corporation, ‘David Capital Inc.’…will be formed by the owners to hire management and operations staff….“ Page 20 of the application states in part, “…EWCDC and our financial partners will own the cafeteria and oversee its management through David Capital, which will hire an experienced cafeteria manager to operate it…”(emphasis added). The David Capital Articles of Incorporation describe the purposes of David Capital. The grant application describes what EWCDC told OCS David Capital’s role would be relative to the project.

Board of Director’s Role In Administering the Grant

Based on the minutes of meetings of the board of directors, EWCDC’s Board played a minimal role in the administration of the OCS grant. We reviewed EWCDC Board and David Capital Interim-Board minutes for meetings that were held from January 8, 1998 to August 21, 2001. The EWCDC Board minutes only covered 11 of the 32 months beginning January 8, 1998 and ending August 21, 2001. The David Capital Board minutes only
covered the 14 months beginning October 20, 1998 and ending December 8, 2000. While we were on site, the Executive Director told us that some of the minutes could not be readily located.

The minutes that were provided to us contained little reference to the administration of the OCS grant. At the March 12, 1998 EWCDC Board meeting, the Board voted to allow the Executive Director to reapply\(^1\) for the $250,000 OCS grant. We could find no other reference to the administration of the OCS grant in any of the other EWCDC Board minutes provided to us.

An interim Board was established for David Capital. The interim board was to function until after the David Capital stock sale had ended. At that time, a permanent Board was to be elected. The minutes of a meeting of the David Capital Board showed that the Board was unclear about the overall intricacies of the cafeteria project. For example, in the January 25, 1999 David Capital Board minutes, the President of the Ministers Conference, who together with EWCDC formed David Capital, asked the EWCDC’s Executive Director to explain the Board’s obligations to David Capital and define David Capital’s relationship to EWCDC. These minutes also show that several board members expressed concern because they were not clear on how the HHS grant worked in relationship to EWCDC and David Capital. For the most part, the minutes discussed the status of the David Capital stock sale and the need to generate additional revenues to fully fund the cafeteria project.

**EWCDC Comments**

The EWCDC officials did not agree with our conclusion that EWCDC’s Board of Directors played a minimal role in the administration of the OCS grant. The EWCDC officials cited discussions in several EWCDC and David Capital Board meetings as evidence of the Board’s more-than-minimal role in the grant’s administration. The EWCDC officials said that there were numerous references to the OCS grant in the minutes. For example:

- The board heard a report on the history of the cafeteria project. (October 20, 1998 David Capital Board Minutes)

- The Board discussed the shortage of banquet and meeting space in Winston-Salem and how the cafeteria could address this need. (November 23, 1998 David Capital Board minutes)

- The Board discussed construction specifics of the cafeteria, including engineering plans and building permits (May 15, 2000 EWCDC/David Capital joint meeting Board minutes)

\(^1\) In October 1996, OCS awarded EWCDC a $75,000 planning grant to develop a business plan, identify a site on which to locate the project, and do a market and feasibility study. While the minutes were not clear, we believe the statement about reapplying relates to the $75,000 planning grant.
The Board discussed at length the leadership situation of the cafeteria project. (November 28, 2000 EWCDC/David Capital joint meeting Board minutes)

The EWCDC officials also said that through the Third-Party Agreement and through project progress reports, OCS was aware that grant funds were used to purchase David Capital stock. The EWCDC officials said that they had made numerous pleas to OCS for help with the project.

**OIG Response**

One of the fiduciary responsibilities of a board is to have a clear understanding of the purpose for which federal grant funds are awarded. The minutes of board meetings we reviewed did not show that EWCDC’s board understood that the grant funds were to be used only for equipment and renovations. None of the board minutes EWCDC provided to us showed that the grants’ terms and conditions were ever discussed and understood. The grant terms and conditions are key elements designed to assure that grant funds are expended for the purposes intended. On the contrary, the January 25, 1999 David Capital Board minutes showed that several board members expressed concern because they were not clear on how the HHS grant worked in relationship to EWCDC and David Capital. Also, minutes of the EWCDC Board meetings contained only one reference to the OCS grant. The OCS grant was only a part of the project, not the project itself. While the minutes EWCDC referred to in its written comments do address the cafeteria project, the minutes do not specifically address the EWCDC’s administration of OCS grant. Thus, we stand by our conclusion that the EWCDC’s Board played a minimal role in the administration of the OCS grant.

We agree that the Third-Party Agreement and the October 26, 1999 project progress report do contain reference to EWCDC using grant funds to purchase David Capital stock. However, informing OCS about actions taken after-the-fact does not constitute prior approval of those actions.

In regard to EWCDC’s request to OCS for help, the grant award document contains a reference to information that could have helped EWCDC in its administration of the grant. The “Remarks” section of the grant award document makes reference to 45 CFR Part 74. The 45 CFR Part 74 provides guidance to grantees in the administration of their federal awards. Among the topics included in Part 74 are standards for financial management systems, budget revision approvals, making audits, and determining allowability of costs. Many of these topics are at issue in this report. Thus, help was available to EWCDC in Part 74. Moreover, the EWCDC and David Capital Board minutes we reviewed did not contain any evidence that showed the Boards were aware of the Part 74 guidance.
Independent Audit

The EWCDC’s last independent audit was performed for the year ended December 31, 1997. At that time, the independent auditors rendered an unqualified opinion in regard to the EWCDC’s financial statements. The independent auditors also reported that EWCDC was involved in three related-party transactions. First, EWCDC was the general partner in the Thirty-Six East Limited Partnership. According to the auditor’s report, EWCDC was secondarily liable for $990,000 of loans related to the partnership’s real estate holdings. Second, EWCDC retained the Executive Director’s brother as its attorney. As of December 31, 1997, the attorney’s services had been provided on a pro bono basis. Third, EWCDC contracted with a construction company owned by the Executive Director’s father for services related to affordable housing activities.

According to the Executive Director, no other independent audits had been performed because EWCDC could not afford to pay for an audit.

The Office of Management and Budget (OMB) Circular A-133, Subpart B, §200, Audit Requirements, states that an audit is required if an entity expends $300,000 or more of federal funds in a year. The EWCDC’s financial records consisted of bank statements, canceled checks, and computer generated spreadsheets prepared by the Executive Director. Because of the condition of the records, we were unable to readily determine if EWCDC met the $300,000 federal expenditure threshold for the years 1998 through 2001.

EWCDC Comments

In written comments to the draft report, EWCDC officials said that the OIG’s discussion of the $300,000 audit threshold for federal fund expenditures was another example of the OIG trying to find something wrong when nothing wrong exists.

OIG Response

We believe EWCDC officials may have misunderstood our discussion of the OMB Circular A-133 audit requirements. Our report states that an entity is required to have an audit only if it expends more than $300,000 of federal funds in a year. Because of the condition of EWCDC’s records, we could not determine if EWCDC was required to have an audit performed because we were unable to readily determine if EWCDC expended more than $300,000 of federal funds in any one year.

Overall Accountability for OCS Grant Funds

The EWCDC did not expend OCS grant funds to renovate the proposed cafeteria site and purchase equipment for the cafeteria’s operation as outlined in its grant proposal that OCS approved. The EWCDC used $150,000 of the OCS grant to purchase stock in David Capital, Inc. The remaining $100,000 of grant funds was co-mingled with EWCDC funds. The EWCDC raised $393,636 for the project from all sources. We were provided canceled...
checks and/or invoices to support $280,425 of expenditures. According to the Executive Director, another $87,273 was expended prior to the grant period for project-related expenses. The remaining $25,938 represents the balance in EWCDC and David Capital bank accounts.

Major expenditures from the co-mingled funds included: $101,000 David Capital paid to the Millennium Group Development, LLC, for landscape, architecture, and design services; $100,696 paid by David Capital to EWCDC for consultant services and that EWCDC paid to others for consulting services; $87,273 for expenses EWCDC incurred prior to the grant period; $41,575 paid by EWCDC and David Capital for marketing, advertising and promotion of the cafeteria project; $20,000 David Capital “loaned” to EWCDC for day-to-day operations; $10,314 paid by EWCDC for legal services; and $6,840 paid for such items as equipment lease/maintenance, accounting fees, postage, utilities, etc. At January 31, 2002, only $25,938 remained in the EWCDC and David Capital bank accounts.

EWCDC Comments

The EWCDC officials said that the draft report is in error in that the grant award document does not say that grant funds were to be used to purchase equipment for the operation of the cafeteria and to fund the cost of the cafeteria renovation.

The EWCDC officials agreed that co-mingling of funds is not the best business practice.

OIG Response

We disagree with EWCDC’s interpretation of the grant award document. In July 1998, OCS raised a question regarding how the grant funds would be used. On July 30, 1998, at OCS’ request, EWCDC officials faxed a copy of a detailed breakdown of the items budgeted in relation to the $250,000 grant. Page 4 of this fax contains a detailed description of the $177,000 of equipment that was to be purchased and a detailed description of what the remaining $73,000 would be used for in relation to the construction budget for leasehold improvements.

We believe that EWCDC’s view of accountability for grant funds is best described on page 9 of its written comments. On page 9 of its comments EWCDC officials said, in part, “…it is reasonable to assume that, while all funds are use (sic) for the same end purpose, the earlier on hand funds, such as the grant funds, will be used for what is needed then, not for the almost last item, restaurant equipment…”

2 In a February 20, 2001 meeting, EWCDC’s Board of Directors gave its approval to request a $20,000 loan from David Capital to be used for EWCDC operating support.
We agree that co-mingling of funds is not a good business practice. We believe that the co-mingling of funds, coupled with EWCDC’s inadequate accounting records, resulted in our not being able to determine if the balance of monies remaining in EWCDC and David Capital bank accounts were federal funds, non-federal funds or a combination of both.

**Sources and Amounts of Project Funds**

From the start, the cafeteria project was seriously undercapitalized. The EWCDC expected to receive funding for the project from several public and private sources. The EWCDC was able to raise only $393,636 for the project - $250,000 from the OCS grant, $136,857 from the sale of David Capital stock to private investors, and $6,779 from interest earned on the grant funds and stock proceeds. In addition to the OCS grant, EWCDC expected to obtain an additional $941,500 from a bank loan and other public and private sources. However, funding from these other sources never materialized.

**EWCDC Comments**

The EWCDC officials agreed that the project was seriously undercapitalized from the start. The EWCDC officials cited several factors involved in the project’s under-capitalization. Such factors included the:

(1) OCS’ failure to approve EWCDC’s 1999 grant request;

(2) sale of stock did not raise as much as anticipated;

(3) loss of the original planned site for the cafeteria because of the site owner’s financial difficulties.

The EWCDC officials also said that the project’s undercapitalization would be even worse if David Capital did not exist.

**OIG Response**

We disagree that OCS’ failure to provide EWCDC additional grant monies caused the project to be undercapitalized from the beginning. According to EWCDC’s May 12, 1999 application to OCS, EWCDC requested $450,000 “…to expand the Eastside Cafeteria and develop an additional 5000 square feet of space…” The fact that OCS did not provide EWCDC with additional money to expand the cafeteria did not contribute to the undercapitalization of the original project.

The $250,000 OCS grant was only a portion of the $1.2 million EWCDC originally budgeted for the cafeteria project. Up until the time the grant was awarded, EWCDC led OCS to believe that EWCDC would have the additional public and private funding necessary to carry out the project. In their written comments, EWCDC officials did not explain why the other
funding sources for the project did not materialize. The EWCDC officials also did not explain how the project’s undercapitalization would be worse without the existence of David Capital. We can only surmise that the EWCDC’s reference to David Capital in this instance refers to the $136,857 raised from private investors through the sale of David Capital stock. Since EWCDC has been able to raise only an additional $143,636 ($136,857 in stock and $6,779 in interest earned) for the project since receiving the OCS grant in September 1998, the project continues to be seriously undercapitalized.

### Draw Downs and Balance of OCS Funds

As of October 12, 1999, EWCDC had drawn down all its OCS grant funds. The EWCDC made five draw downs of grant funds as follows:

- $19,000 on November 12, 1998;
- $10,000 on December 8, 1998;
- $200,000 on January 14, 1999;
- $20,000 on February 17, 1999; and
- $1,000 on October 12, 1999.

As of January 31, 2002, cash account balances at EWCDC and David Capital totaled $25,938. Because the grant funds were co-mingled with funds from the sale of David Capital stock, we could not determine how much of the funds remaining were OCS grant funds.

### EWCDC Comments

EWCDC had no specific comments regarding the drawdowns of grant funds.

Although EWCDC officials agreed that co-mingling of funds is not a good business practice, EWCDC officials stated that it did not matter whether any of the remaining $25,938 in bank accounts at EWCDC and David Capital were grant funds or not. The officials said that it did not matter because the remaining funds, if they belong to EWCDC, will be used for the creation of the cafeteria, just as all of the other money it has received, has been used.

### OIG Response

Because we are recommending that EWCDC refund the entire grant amount, we have no specific response to EWCDC’s comments.

### Procurement Procedures Relative to the OCS Grant

The EWCDC did not have formalized procurement procedures. On June 4, 1999, EWCDC entered into a sole-source contract with another for-profit company, the Millennium Group Development, LLC, for the procurement of landscape, architecture, and design services. The Millennium Groups’ President is also the brother of EWCDC’s Executive Director.
According to the Executive Director, no formal bids were sought for the service contract because the Millennium Group was to provide their services as a turnkey operation. Millennium Group was to provide the land for a newly selected site for the cafeteria.

**EWCDC Comments**

The EWCDC officials agreed that they did not have formalized procurement procedures. They also said EWCDC did not have to have procurement procedures.

The EWCDC officials also stated their willingness to void the current sole source contract with Millennium Group and have the job competitively bid. They also said it would likely be a waste of time to competitively bid the contract because, in all probability, the Millennium Group would be the only bidder.

**OIG Response**

The 45 CFR Part 74.44 requires grant recipients to have written procurement procedures. Good business practices also support the need for written procurement procedures. Written procurement procedures are necessary to ensure that all procurement transactions are, to the maximum extent practical, conducted in a manner that provides open and free competition.

Also, sole source contracts ordinarily contain justification as to why a particular entity is the only source for a product or service. The EWCDC did not provide any documentation to show why Millennium Group was the only source for the project’s landscape, architecture, and design services.

**Controls Over Equipment Purchased with OCS Grant Funds**

The EWCDC did not purchase any equipment with grant funds as proposed in its application to OCS and as stipulated in the grant award document. Therefore, we did not test the adequacy of EWCDC’s inventory records relative to the OCS grant.

**EWCDC Comments**

The EWCDC officials said that the draft report’s discussion of controls over equipment purchased with OCS grant funds appears to have no other purpose other than another opportunity to misstate the purpose of the grant. The officials also acknowledged that no restaurant equipment has yet been purchased. The EWCDC officials further stated that it would not have made sense for them to purchase equipment for a cafeteria that did not exist.
OIG Response

We agree that it may not have been prudent for EWCDC to purchase the equipment before the cafeteria was completed. However, we do not believe EWCDC should have expended grant funds awarded specifically for the equipment for other purposes. It would have been more prudent for EWCDC to have not drawn down the grant funds awarded for the equipment until the equipment was needed for the cafeteria’s operation. Similarly, EWCDC should not have drawn down grant funds awarded for renovation until it had a facility to renovate.

Major Unapproved Programmatic or Budget Change

One major programmatic and budgetary change was cited in the Third-Party Agreement between EWCDC and David Capital. The David Capital Board approved the agreement in a November 23, 1998 meeting. The agreement shows that it was entered into by both parties on November 27, 1998, but was not signed by both parties until January 22, 1999.

The agreement included a section on “Sources” and “Uses” of funds. According to the agreement, the total cost of the project had increased from $1,191,500 to $1,675,000 or $483,500 more than was shown in EWCDC’s grant application. The agreement also showed that the increased funding was to be derived from: (1) the sale of stock - $225,000, (2) bank loan - $650,000 ($408,500 more than was shown in the grant application); and (3) City of Winston-Salem - $350,000 ($100,000 more than was shown in the grant application). Under the heading, “Uses” of funds, the agreement now showed “land” at a cost of $170,000 and “building” at a cost of $720,000. A discussion with the Executive Director disclosed that this change in the project’s scope and budget arose from the Ministers Association’s desire to add a banquet facility to the cafeteria. We found no evidence that EWCDC received prior approval from OCS for this change in the project’s scope and budget.

Another change in the project’s scope arose when EWCDC used grant funds to purchase stock in David Capital. According to the grant application, David Capital’s role was to hire management and operations staff for the cafeteria project. However, the Third-Party Agreement showed that David Capital hired EWCDC as the Manager and Developer of the cafeteria project. According to the agreement, EWCDC’s duties and responsibilities would include providing oversight for the development of the cafeteria project and the sale of stock, and assist in the design, documentation, and permitting of a commercial facility for the purpose of building a cafeteria.

Representatives from OCS made site visits to EWCDC in September 1999 and November 2001. However, we found no evidence that OCS had approved changes in the project’s scope that allowed: (1) David Capital to hire EWCDC to perform the functions that David Capital was formed to do, and (2) EWCDC to build a cafeteria rather than make leasehold improvements to existing space as outlined in the grant application.
EWCDC Comments

The EWCDC officials said that the following draft report statement was untrue: “Another change in the project’s scope arose when EWCDC used grant funds to purchase stock in David Capital”. As evidence of the statement’s untruthfulness, EWCDC officials cited a passage from a letter on page 61 of the 1998 grant application that said: “The East Winston CDC will use the proceeds from this application to purchase its share of stock under the Rule 504 offering.”

The EWCDC officials further asserted that the Third-Party Agreement is evidence that OCS approved EWCDC’s building of a cafeteria rather than making leasehold improvements to existing space.

Additionally, EWDC officials said that OCS failed to provide any meaningful assistance to the EWCDC after the grant was made.

OIG Response

The letter EWCDC referred to on page 61 of the grant application is from the Chairman of David Capital to EWCDC’s Executive Director. While this letter does state that EWCDC will use the proceeds from this application to purchase its share of stock, the letter does not constitute OCS’ prior written approval to purchase David Capital stock with grant funds.

We disagree with EWCDC’s assertion that OCS provided tacit approval for the change in scope to allow EWCDC to build a cafeteria rather than make leasehold improvements to an existing site. The project’s scope was delineated in EWCDC’s grant application, not in its Third-Party Agreement with David Capital. Changes in the project’s scope required OCS’ prior written approval.

While we cannot comment on OCS’ lack of response to EWCDC’s requests for help or the OCS’ site visits, we do offer the following. First, these site visits would have provided excellent opportunities for EWCDC to discuss and seek guidance on any problems they were encountering with the project. Second, nothing in the EWCDC written comments indicates that EWCDC availed themselves of these opportunities.

RECOMMENDATIONS

We recommend that OCS:

- recover the $250,000 of grant funds; and
- assure that EWCDC evaluates its ability to properly control and account for federal funds before submitting future HHS grant proposals.
We would appreciate being advised on the status of corrective actions within 60 days of the date of this memorandum. Should you wish to discuss the issues raised in our report, please call me at (404) 562-7750 or have your staff call John Drake, Audit Manager, at (404) 562-7755.

To facilitate identification, please refer to Common Identification Number (CIN) A-04-02-00010 in all correspondence relating to this report.

Charles J. Carter
July 1, 2002

Charles J. Curtis
Regional Inspector General
For Audit Services, Region IV
Department of Health & Human Services
Room 3141 - 3 1 4
61 Forsyth Street, S.W.
Atlanta, GA 30303-8909

RE: Results of Review – East Winston Community Development Corporation’s Administration of Office of Community Services Discretionary Grant No. 90EE0353/01 Common Identification Number (CIN) A-04-02-00010

Dear Mr. Curtis:

Now comes East Winston Community Development Corporation (EWCD), through counsel, formally responding to the draft report referenced above (Marked EXHIBIT 1), covering letter dated May 15, 2002.

You advised in your covering letter (Marked EXHIBIT 2) that the draft report was to be safeguarded against unauthorized use and that it would not be in the public domain until it became final. It is with regret that we must inform you that a *, who is referred to as “deputy director of community services” of Health and Human Services, discussed this draft audit with the Winston-Salem Chronicle, a newspaper in Winston-Salem, NC, at or about the time it was finalized. Note the enclosed news article from the May 23 2002 Chronicle (Marked EXHIBIT 3).

In that the draft report itself states that, “NOTICE – THIS DRAFT RESTRICTED TO OFFICIAL USE” (Marked EXHIBIT 4) and states that, “recipients of this draft should not disclose its contents other than for official review and comment under any circumstances”, we herein formally request you to investigate and report to us why these directions were breached. We believe that our position has been severely compromised by efforts on the part of someone to play this matter in the media. You restricted us from replying to an unfair attack and we are entitled to an explanation as well as consideration and we hereby make this request. If the answer is that * did not discuss the draft, but merely volunteered the information that an audit was being conducted, we are of the opinion that, while this may follow the letter of the prohibition under which we are placed, it certainly is not the spirit thereof. More importantly, a fair reading of the referenced news article makes it clear that * discussed the contents of the audit, not just the existence thereof, with the news media.

The draft report itself is a cobbling together of innuendoes, half-truths, and misstatements, aided by errors of omission and commission, to reach the totally

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
unwarranted conclusion that the Office of Community Services (OCS) recover the $250,000 of grant funds. EWCDC accepts and agrees that it, just as all grant recipients should, be required to evaluate the ability to properly control and account for Federal funds before submitting grant proposals.

We will not herein attempt to show that EWCDC is perfect, nor will we not disagree that some matters could, and, probably should, have been handled differently. However, we will show conclusively that the recommendation that the grant funds be recovered is improper.

In the BACKGROUND section of the draft report it is stated that, EWCDC applied on May 18, 1998 for a grant, and it is further stated that “According to the grant application, the Eastside Cafeteria was to be owned by the EWCDC and the Ministers Conference of Winston-Salem and Vicinity”. This statement is an obvious error on the part of the grant applicant writer and was apparently ignored by OCS in making the grant. On page 9 of the grant application (Marked EXHIBIT 5) reference is made to cooperation on other projects with the Ministers Conference, but there is no statement whatsoever there that the Ministers Conference will be an owner. The grant application does state thereat, that churches will be part owners of the proposed cafeteria. While no survey is currently available, it is respectfully submitted that many of the owners are church members.

The draft audit report is replete throughout with language implying that wrongdoing occurred because something did not happen as planned, or at least hoped for. A prime example of this type of McCarthyism is the statement that per the grant application it was proposed that a staff of six carry out the project. This is followed up by the report noting out that the organizational chart showed “four employees in place at EWCDC at one time” (Note that two of them could not reasonably be expected to have much more than minimal contact with the cafeteria project), but that at the time of the audit only two employees of EWCDC work on the cafeteria project. Accepting that the combined balance of funds in the EWCDC and David Capital accounts was only $25,938 at the time of the audit (it should be noted that the herein response is not being prepared as pro-bono legal work), why should there be seven employees on a stalled cafeteria project, or four? A better question would be, why are there any? If there were seven, or four, what would the audit have them paid with? At least, paid for very long. EWCDC should be commended, not criticized for not spending the grant funds on excessive and unneeded employees.

Even worse, the auditors misread the grant application completely when the following statement was inserted into the draft audit report “In the grant application EWCDC proposed a staff of six, plus seven volunteers to carry out the project.” That is not what the grant application says. Page 10 “EWCDC will have a staff of six ... EWCDC now has seven volunteers and is conducting an aggressive recruiting campaign.” It is more than clear that the grant application is referring to the entire EWCDC staff, not just the cafeteria project staff.

If it is to be assumed that the concluding paragraph of the BACKGROUND section of the draft audit report wherein reference is made to the September 18, 1998 grant award is based upon the DGCM-3-785 (Rev. 86) form attached to a letter dated September 14, 1998 from * Director, Office of Community Services (Marked EXHIBIT 6)

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
then the designations on the said form do not match up with the language in the draft audit report. The form says “Equipment...$177,000”. The draft audit report says “purchase equipment ($177,000) for the cafeteria’s operation”. The draft audit report makes a mighty leap. Only the dollar figure and the word “equipment” are the same. The other reference is even more out of line with reality, clearness, and more importantly, legal meaning. The form says “Other...$73,000”. The draft audit report says, “to fund the cost of the cafeteria renovation”. It is submitted that according to most standard dictionaries “other” has several meanings. However, none of them consulted thus far say the “other” means “to fund the cost of the cafeteria renovation”.

It is noted that per the Scope section of the draft report that EWCDC is not required to have an adequate internal control structure because of its small size. If EWCDC is not required to have same the only reason for pointing out that it does not have one is to imply that it should even though it is not required to.

Much is made in the Stock Purchase section of the FINDINGS AND RECOMMENDATIONS section of the draft report about the fact that more than one check was written to David Capital, Inc. (David Capital) for the purchase of stock therein by EWCDC. The explanation given that the aim was to establish good banking relationships is perfectly valid and should be commended, not condemned. Unfortunately, due to no fault of EWCDC, these relationships have not resulted in additional financing, as yet. However, this may still occur.

It is noted from the draft report that the necessary third party agreement was in place allowing the use of grant proceeds to purchase stock in David Capital, even though the 1998 grant application does not refer thereto. For OCS to raise this issue formally for the first time on May 15, 2002 is outrageous, particularly in that OCS, has known at least since the day it received the May 1998 grant application (See EXHIBIT 5) that EWCDC would have an ownership position in David Capital. Certainly it knew on March 29, 1999, and probably knew from day one, the details of the stock purchase and has given tacit approval, if not actual written approval, certainly verbal approvals, thereto, for several years. Even if OCS were to deny everything else that it cannot find in writing in its files it cannot be heard to deny the very words of the grant application. Page 20 “EWCDC and our financial partners will own the cafeteria and oversee its management through David Capital, which will hire an experienced cafeteria manager to operate it”. OCS may have misread this sentence to mean what the auditors now claim it means, i.e., that David Capital is only managing, but the clear and unequivocal meaning of the sentence cannot be denied. It says, and means: EWCDC WILL OWN THE CAFETERIA THROUGH DAVID CAPITAL. EWCDC told OCS what it was going to do, and did it. If OCS did not understand that this meant an investment in David Capital that certainly can be used at this late date as an excuse.

It is not difficult to understand how the auditors misunderstood the relationship between the Minister’s Conference of Winston-Salem and Vicinity when the letter from President thereof, dated May 13, 1998 (See EXHIBIT 5) is examined. * refers to EWCDC and the said association partnering to form David Capital. This is an all too common modern hackneyed misuse of the legal term “partner. The word, as used by, is a more obscure, at least until the current unfortunate, but all too overused, usage, to wit: “player on the same side”.[See page 60 of

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
Appendix Page 4 of 18

the grant application of May 1999 (Marked EXHIBIT 7), which is a letter from Goodwill Industries of Northwest North Carolina, Inc. wherein a reference is made to the partnership of Goodwill Industries to EWCDC for another example of the modern misuse of the legal meaning of the term]. When the entire letter is read in context it is perfectly clear that * is writing about churches, actually more likely church members, being investors in David Capital. It is impossible to understand how the auditors could miss the clear statement that EWCDC was to be a shareholder in David Capital. OCS knew from day one about EWCDC's planned investment in David Capital. Unfortunately, * misuse of the partnering term is carried over into other documents and causes much confusion as a result thereof. However, the facts are clear.

On March 29, 1999 the then Chairperson of EWCDC, wrote OCS, referencing the 90EE0353 grant and requesting a discussion of changes to the original grant application (Marked EXHIBIT 8). OCS made no response whatsoever. If OCS now claims that it responded to the said letter, it is herein called upon to produce same. EWCDC was certainly entitled to rely on the complete silence of OCS as full consent, especially in that the said letter included full and complete documentation of what had occurred. Even so, there is much additional evidence that OCS knew exactly what had occurred, and more importantly, raised no objection whatsoever thereto.

Page 6 of the grant application (See EXHIBIT 5) refers to "a community-owned cafeteria-style restaurant". It is obvious that for there to be community ownership there had to be a for profit stock corporation involved.

In the Report for the Period April, 1999 to August 1999 (Marked EXHIBIT 9) filed with OCS by EWCDC the stock purchase is described in detail.

In the Semi-Annual Report for the Period July, 1999 to January, 2000 (Marked EXHIBIT 10) filed with OCS by EWCDC reference is made to the stock ownership of EWCDC.

In the Semi-Annual Report for the Period April, 2000 to September 2000 (Marked EXHIBIT 11) filed with OCS by EWCDC reference is made to the stock ownership by EWCDC in David Capital.

In the Semi-Annual Report for the Period October 2000 to March 2001 (Marked EXHIBIT 12) filed with OCS by EWCDC reference is made to the stock ownership in David Capital by EWCDC.

It is clear that OCS knew from the beginning what the grant funds were going to be used for, how they were used, and what occurred, all in full and complete detail. To say that EWCDC did not make a specific request and that OCS did not grant approval for the use of grant funds to purchase David Capital stock is an attempt to rely on what OCS might like the situation to be rather than what the truth actually is. Having waited for more than four years OCS certainly cannot now be heard to complain about something that it knew about all along.

It is noted that both the draft audit report and EWCDC make unfortunately loose references to the amount of stock in David Capital purchased. The draft audit report, page 4, states that the amount of the grant funds so used was $150,000 (which is the correct

* In accordance with OIG-OAS Policy, the names of individuals have been deleted. 4
amount). Page 5, however, refers to 25,000 shares which would make the investment $250,000. It appears that what the actual situation was that the EWCDC board agreed to a $250,000 purchase, but only $150,000 was so invested. The Third Party Agreement (Marked EXHIBIT 13) of which OCS was aware having suggested that it be prepared called for the purchase of 25,000 shares at $10.00 per share for a total investment of $250,000.

The matter of the letter of EWCDC Chairperson * , dated March 29, 1999 (See EXHIBIT 8) will be covered in further detail herein.

The draft audit report makes the completely subjective determination that the EWCDC Board of Director’s “played a minimal role in the administration of the OCS grant”. The exact opposite is true. The minutes examined in the audit can be read to show that the Board relied on the Executive Director to oversee the project by their lack of active involvement or concern. It certainly can be argued that a Board of Directors should not function in this manner, but it is certainly a fact that many, if not most, boards of non-profits, and all too many for profits, operate in this fashion.

However, a fair examination of the available minutes of board meetings of EWCDC shows an extremely active board in the administration of the referenced grant, to wit:

March 12, 1998 EWCDC Board Minutes (Marked EXHIBIT 14): The Board gave unanimous approval to apply to HHS for a grant.

February 24, 2000 EWCDC Board Minutes (Marked EXHIBIT 15): A business plan for the cafeteria was being developed.

February 20, 2001 EWCDC Board Minutes (Marked EXHIBIT 16): Possible relocation of the cafeteria site discussed at length.

Switching horses, the draft audit report makes the completely subjective determination that the David Capital Board of Director’s was “unclear about the overall intricacies”, wanted explanations and definitions, and “expressed concern”. Thus, the draft audit report attempts to have it both ways, David Capital’s Board is wrong because it asked questions, and got answers, and EWCDC’s Board is wrong because it did not ask questions.

There is no one single way in which a board, or board member, in a for profit, or a non-profit, should act. Perhaps the best advice is that at each meeting the determination must be made as to whether or not to fire the CEO, and if the decision is to not fire the CEO the next issue is what can we do as a board, and as board members, to fully and completely support the CEO. It is submitted that both the EWCDC Board of Directors, and the David Capital Board of Directors met their legal and fiduciary requirements.

The draft audit report concludes that the David Capital Board spent most of their time discussing the stock sale and the need to generate additional revenues to fund the project. Of course they did. Without funds the project certainly could not get off the ground and it was certainly pointless to discuss the cafeteria menu (which the Board should not be doing anyway), if there was not going to be money to build it with. The statement contained in the draft audit report, to wit: “From the start, the cafeteria project was seriously undercapitalized.”, cannot be disagreed with. Of course, the failure of OCS to approve the grant request of May 12, 1999 is a very large part of the problem.

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
An examination of the composition of the boards of EWCDC and of David Capital shows much overlap. Many of the board members served on both boards. It is not reasonable to assume that if the matter were discussed at one board meeting that the same matter would be brought up by the same board member at the meeting of the other organization. If a board member got the answer to a question at one meeting this knowledge carried over to the meeting of the other board.

The Board of Directors of David Capital with much overlapping, and frequently joint meetings with, EWCDC, certainly did not spend all of their time discussing the sale of its stock. A fair examination of the available minutes clearly shows otherwise, to wit:

October 20, 1998 David Capital Board Minutes (Marked EXHIBIT 17): The Board heard a report on the history of the cafeteria project. The Board heard a report on the problems with the East Winston Shopping Center. The Board adopted a resolution to set up three additional bank accounts. The Board approved a name for the cafeteria. The Board discussed the hiring of a Project Manager. The Board agreed to form a Committee to recommend a Project Manager. The Board discussed the training of cafeteria employees. The Board agreed to visit a cafeteria in Charlotte, NC to observe its management company.

November 23, 1998 David Capital Board Minutes (Marked EXHIBIT 18): The Board discussed the shortage of banquet and meeting space in Winston-Salem and how could the cafeteria address this need. Five Board members reported on their Charlotte, NC cafeteria trip, the discussions that took place, and the information received to assist the Winston-Salem cafeteria project. The Board discussed the search for a Project Manager for the cafeteria project. The Board received a briefing on possible sites for the cafeteria.

December 23, 1998 David Capital Board Minutes (Marked EXHIBIT 19): The Board received a report on the expenditures on the cafeteria project by EWCDC since 1997.

January 25, 1999 David Capital Board Minutes (Marked EXHIBIT 20): The Board discussed institutional food service companies in their relationship to the management of the cafeteria. The Board again discussed the lack of meeting space of sufficient size to accommodate special events and the relationship of this situation to the cafeteria project. The Board received a report on the naming of the cafeteria. The Board received a report on the financial status of EWCDC. The Board discussed the hiring of a Project Manager, and how expensive this would be.

February 11, 1999 David Capital Board Minutes (Marked EXHIBIT 21): The Board asked its Finance Committee to review the past expenditures of EWCDC and report to the Board. The Board discussed the hiring of a Project Manager, including the problem that many candidates did not understand the project and what community development entails. The possibility of locating the cafeteria on the Goler AME Zion Church site was reported upon.

April 20, 1999 David Capital Board Minutes (Marked EXHIBIT 22): The Board discussed the Goler Church cafeteria site, and another possible site. The Board received a report on past expenditures related to the cafeteria. The Board discussed the lack of assistance that the cafeteria project had received from HHS. A request was made that a letter be written to HHS, signed by the Board Chairman of EWCDC requesting help from HHS.
May 18, 1999 David Capital Board Minutes (Marked EXHIBIT 23): The Board discussed a cafeteria site. The relationship of various parties that might be involved was discussed at length. The Board wanted it made clear that there had to be full disclosure and that everything had to be done above board.

May 15, 2000 EWCDC/David Capital joint meeting Board Minutes (Marked EXHIBIT 24): The Board discussed construction specifics of the cafeteria, including engineering plans and building permits. The Board discussed in depth the construction specifications including the quality of the furnishings and carpet to be used in the cafeteria project. The Board discussed if there was a necessity for an interior decorator to be sure everything was well coordinated.

August 24, 2000 EWCDC/David Capital joint meeting Board Minutes (Marked EXHIBIT 25): The Board discussed the proper way to give the community an update on the cafeteria project.

November 25, 2000 EWCDC/David Capital joint meeting Board Minutes (Marked EXHIBIT 26): The Board discussed at length the leadership situation of the cafeteria project.

December 8, 2000 EWCDC/David Capital joint meeting Board Minutes (Marked EXHIBIT 27): The Board received a report about providing information to other groups about the cafeteria project.

All of the above referenced minutes of EWCDC and David Capital were provided to the auditors, and were kept by the auditors until June 13, 2002, albeit perhaps by error, until finally returned to EWCDC by the auditors, per the request of EWCDC. It would certainly appear that the auditors had much more than adequate time to find the numerous references to the OCS grant in the minutes.

Finally, it must be pointed out that both the EWCDC Board of Directors and the David Capital Board of Directors were comprised of people who were completely at home in the boardroom. This was not the only board on which any of them served. They knew what it was to serve on a non-profit board, they knew what their duties were, and they knew when to ask questions and when to keep quiet. A short biography of the board members of both EWCDC and David Capital as of June 5, 1999 is contained in the brochure prepared for the stockholders advisory meeting (Marked EXHIBIT 28).

It must be noted that this section of the draft audit report makes the statement that the President of the Minister’s Conference, together with EWCDC formed David Capital. In the Background section of the report it is stated that EWCDC and the Ministers Conference formed David Capital. Neither is correct, nor would this be likely under North Carolina law (the Methodology section of the report notes that David Capital is a North Carolina Corporation). N.C.G.S. 55-2-01 requires a “person” to act as the incorporator of a corporation. N.C.G.S. 55-1-40 (16) defines “person” as including an “individual” and an “entity”. N.C.G.S. 55-1-40 (9) defines “entity” in a manner that might perhaps be broad enough to cover the Ministers Conference of Winston-Salem and Vicinity, but then again it might not. “Person” certainly covers the individual who was president of the Ministers Conference. Normally, the incorporator, or forming person, of a North Carolina corporation is a natural person. That certainly is the situation here. The person who formed (the incorporator) David Capital, was * according to the Articles of Incorporation (Marked EXHIBIT 29). It certainly was not EWCDC, The Ministers Conference, or the President of the Ministers Conference according to the

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
records on file in the Office of the North Carolina Secretary of State and reviewed per the Methodology section of the report.

It appears that the only reason for the Independent Audit section of the draft report is to attempt by innuendo to smear others involved in attempting to help with the cafeteria project. The audit is for the period ended December 31, 1997. Months before the grant application in question was even prepared. The opinion was unqualified. It noted three related party transactions. None of them have anything to do with the $250,000.00 grant whatsoever. The sole purpose for including a reference to this audit appears to be a device to say that EWCD gathered Executive Director’s brother as its attorney, abeit for free, and that a construction company owned by the Executive Director’s father had something to do with EWCD’s housing activities. To attempt to imply that dealing with these related parties is wrong, without any proof, of any kind, whatsoever, is simply unwarranted. It is as if to say that the entire draft audit report is tainted and wrong because the Inspector General of the Department of Health and Human Resources, under whose name is report was prepared, is the daughter of the Chief Justice of the United States of America. (See EXHIBIT 4). It is noted that the attorney’s services were provided on a pro-bono basis. Free legal services are hard to come by. This should be a commendation instead of an implied criticism. The other so-called related party transaction had to do with housing aspects of EWCD’s mission. None of the three items of which the draft audit report comments upon in detail had anything whatsoever to do with the cafeteria, the grant, or anything else even vaguely related in any way to the question at issue herein.

The draft audit report makes much of the payments made for consulting services in the section in the Overall Accountability for OCS Grant Funds section, yet felt it necessary to point out earlier EWCD did not expend funds for additional consultants, i.e., other independent auditors.

The issue of the $300,000 Federal funds expenditure audit threshold requirement is another example of trying to find something wrong when nothing exists. The grant was for $250,000 in 1998. There had been a $75,000 planning grant in 1996. However, $87,273 was expended prior to the 1998 grant. If you only had $250,000 to start with, how could there be any possibility that $300,000 could have been expended in any one year during the period 1998 through 2001? If it is clear that the regulation has not been violated, and it certainly is clear in the herein instance, what is the reason for the matter to be reported upon in this manner?

As no restaurant equipment had been purchased at the time of the audit there was no requirement that EWCD have inventory records relative to the OCS grant. The draft audit report refers to it being stipulated in the grant award document that the grant funds would be used for the purchase of equipment. Assuming that reference is being made to EXHIBIT 6, the word stipulation is not used therein. To stipulate means to demand something or to specify as part of an agreement. The language used in EXHIBIT 6 simply does not do this.

The crux of the matter is was the $250,000 in grant funds properly expended. The draft audit report finally gets to this issue in the section entitled Overall Accountability for OCS Grant Funds. Using the figures in the report $150,000 was used to purchase stock in
David Capital, but David Capital paid EWCDC $101,696. Thus, EWCDC’s net expended funds to David Capital were less than $50,000. In addition, David Capital has loaned EWCDC $20,000, thereby further reducing the net outlay to less than $30,000, or less than 12% of the grant.

Page 6 of the grant request contains the following two statements:

"requests $250,000 for EWCDC to create a community-owned, cafeteria-style restaurant"

"The grant will be used for restaurant equipment necessary for the startup of the cafeteria"

Page 11 of the grant request contains the following statement:

"to create a community-owned, cafeteria-style restaurant.”

Page 28 (EXHIBIT 3) of the grant request states that $310,000 was to be used for “Equipment, Furniture & Fixtures” However, this page also states that an additional $1,325,000 was to be used for other costs associated with the proposed cafeteria.

Finally, the cover form, Standard Form 424 (Rev 7-97), dated May 14, 1998, contains the following:

“11. DESCRIPTIVE TITLE OF APPLICANT'S PROJECT:

To develop a cafeteria-style restaurant to serve our low-income community”

The point of all this is that all the funds expended have been expended to create the purpose for which the grant was made, to wit: The creation of a community-owned, cafeteria-style restaurant. While it is certainly true that no funds, to date, have been expended to purchase restaurant equipment as the project for various reasons has not gotten to this stage as yet. It is further noted that the draft audit report refers to, “the cafeteria’s operation”. Nowhere in the application is reference made to cafeteria operation as a used for the grant funds. Have to get the business started first and that includes the items for which the grant money was expended.

As OCS knew from the grant application this was to be a multi-funded project. It is reasonable to assume that, while all funds are use for the same end purpose, the earlier on hand funds, such as the grant funds, will be used for what is needed then, not for the almost last item, restaurant equipment.

The May 18, 1998 grant request made many references as to what the cafeteria will do. Just to list a few:

Page 11: “creating 30 full-time equivalent jobs for our community.”
Page 14: “The building will seat 175 people in 8,500 square feet of space.”
Page 15: “Average meal prices are projected at $3.50 for breakfast....”

This listing of what the cafeteria will do could do goes on and on. The reason for emphasizing the very numerous references to what the cafeteria planned to do is to vividly highlight that the object was to have a cafeteria in East Winston and that while many items were in the early stages, the details remained to be worked out. Would the grant money have not been spent as outlined in the grant proposal if the cafeteria created
45 jobs; if the building was 8,000 square feet; if it seated 168 people; or if breakfast cost $4.25? Of course not. Neither has the grant money been improperly expended when it was used to create a cafeteria, even though it was not spent to purchase cafeteria equipment!

"From the start, the cafeteria project was seriously undercapitalized." As previously stated EWCDC fully agrees with this conclusion. Of course, this conclusion is complete hindsight. If OCS had thought the project was undercapitalized it would never have made the grant in the first place. OCS, as did EWCDC, thought that the project was viable as originally planned. Obviously, it was not. Why? The sale of stock did not raise as much as anticipated. It must be pointed out that the undercapitalization would be even worse if David Capital did not exist. The draft audit report devotes much attention to the sale of David Capital stock throughout, including the mere existence thereof, and then is critical because not enough stock was sold to raise the necessary funds. Other factors involved in what turned out to be an undercapitalization of the project, in addition to the failure of OCS to fund the 1999 grant request, include the loss of the original planned site of the cafeteria because of the financial difficulties of the then owner (it is noted that this problem, which was in no way the fault of EWCDC, is totally ignored in the draft audit report), and, thus far, not having received the necessary additional public and private investment. The point is clear. The project was undercapitalized. EWCDC knows that now. OCS knows that now. Neither OCS, nor EWCDC knew that over four full years ago when the grant was approved.

The Overall Accountability for OCS Grant Funds, the Sources and Amounts of Project Funds, and the Draw Downs and Balance of OCS Funds sections of the draft audit report are all rehashes of the same figures. In three separate places it is stated that the bank account balance is $25,938. One can assume that this $25,938 is all part of the $250,000 grant, or one can assume that none of it is. It simply does not matter. The draft audit report does not claim that one single penny of the grant was misspent. Certainly, the investment in David Capital is criticized, but over 58 percent money ended up back with EWCDC, and the remainder of it was spent on trying to get the cafeteria up and running. It can safely be assumed that if the remaining $25,938 belongs to EWCDC it will be expended on the creation of the cafeteria, just as all of the other money it received has been. Likewise, it can safely be assumed that if the remaining $25,938 belongs to David Capital it will be expended on the creation of the cafeteria, just as all of the other money it received has been.

The three referenced sections of the draft audit report mention that the funds of EWCDC and David Capital were co-mingled. Again, as is so prevalent throughout the said report, a word or statement, is made, and repeated, for no apparent purpose than to attempt to make EWCDC look bad, without any evidence whatsoever that any wrongdoing of any kind or nature whatsoever, occurred. While co-mingling of funds is certainly not the best business practice, it, by itself, is no evidence of wrongdoing.

The Procurement Procedures Relative to the OCS Grant section of the draft audit report starts off with the statement that, "The EWCDC did not have formalized procurement procedures." Did it have to? Of course not. The sole purpose of leading off with this statement apparently is to imply that it should have had. Two other and similar implications make up this entire section. It is correct that EWCDC entered in an
agreement with Millennium Group, LLC (Marked EXHIBIT 35). Mention is made that this was a sole-source arrangement without formal bids. The draft audit report makes no mention of this being wrong, improper, or illegal. If it is, the draft audit report did not say so. Even so, EWCDC will, by agreement with Millennium, void the present contract, and have the job competitively bid. This will very likely be a waste of time to all concerned as there will, in all probability, be only one bidder, the Millennium Group, LLC, but if OCS would prefer it this way, so be it. Actually, the current position of Millennium is that it will not be the contractor for the construction of the cafeteria project. Mention is again made of the fact that EWCDC has had dealings with relatives of its Executive Director. No mention, other than by implication that this is wrong. We have already commented upon this guilt by association innuendo, on both EWCDC's side, and the government's side.

The Controls Over Equipment Purchased with OCS Grant Funds appears to have no purpose other than to be another opportunity for the draft audit report to misstate what the grant was for. It is acknowledged that no restaurant equipment has yet been purchased. What was EWCDC to do with restaurant equipment before the building was ready to install it therein? Pay storage on it? If EWCDC did not have to have procurement procedures because it did not procure anything, it certainly did not have to have inventory records on an inventory that did not exist. This is no place to attempt to be humorous, but much of the entire draft audit report is about like saying that the officials of the audited organization did not dress in green, have their heads shaved, and wore their shoes unshined. They simply did not have to do these things.

Once again, the lead in paragraph of a section attempts to show that EWCDC did something improper by stating facts of no possible significance. In the Major Unapproved Programmatic or Budget Changes it is stated that an agreement between EWCDC and David Capital was approved by David Capital on November 23, 1998, and that the agreement was not signed by both parties until January 23, 1999, even though the agreement shows it was entered into on November 27, 1998. There is absolutely nothing legally wrong with this agreement and to attempt to imply that there is by the stating of the facts surrounding its execution borders on the unbelievable.

The Third Party Agreement (See EXHIBIT 13) correctly shows that as of November 27, 1998 the cost of the project had increased to $1,675,000. Obviously, this increase resulted in an increase in the funds from the sources from which the increased funding was to be derived.

Reference is made to the functions that David Capital was formed to do. Article I., of the Articles of Incorporation of David Capital (See Exhibit 29)states the functions for which it was formed, to wit:

"The purposes of the corporation are (i) to promote community development of the area in which the principal office is located and (ii) such other purposes as are permitted for general business corporations."

Nowhere in the formation document does it say that David Capital had any other function other than as above set out. It is simply impossible to determine how the draft audit report could reach the conclusion that it did in regard to the functions of David Capital.
It is truly unfortunate that it was necessary herein to expend a great deal of, if not all of, and very likely more than, the remaining grant funds to attempt to prove absolutely, and without a shadow of a doubt, the complete untruthfulness of the following statement made in the Major Unapproved Programmatic or Budget Changes of the draft audit report, to wit: "Another change in the project’s scope arose when EWDC used grant funds to purchase stock in David Capital.” Appendix I., page 61, of the grant application (See Exhibit 5) is the smoking gun that puts this matter to complete rest! The document is a letter dated May 12, 1998 from * Chairman of David Capital to EWDC. It reads in pertinent part: "DAVID CAPITAL, INC (DCI) WILL MAKE A RULE 504 EXEMPT OFFERING OF ITS STOCK TO THE MARKET AREA OF THE PROPOSED CAFETERIA. APPROXIMATELY $250,000 IN STOCK WILL BE ALLOCATED UNDER THE OFFERING TO THE EAST WINSTON CDC, $250,000 TO THE MINISTERS CONFERENCE AND VICINITY.

THE EAST WINSTON CDC WILL USE THE PROCEEDS FROM THIS APPLICATION TO PURCHASE ITS SHARE OF STOCK UNDER THE RULE 504 OFFERING.” (emphasis supplied).

The clear and unequivocal language of this portion of the grant application is impossible of misinterpretation.

It is, of course, obvious that the budget increased. As to the increase in scope of the project, the grant application (See EXHIBIT 5) clearly shows that this was anticipated therein. Page 14 mentions attempting to secure a mobile meals contract, which is simply another form of catering. Page 15 refers to bidding on a contract that would entail serving 75,000 meals per year away from the cafeteria site, as well as bidding on other catering away from the cafeteria site. Page 20 sets out the expectation that the cafeteria will include banquet facilities for wedding receptions, business breakfast, etc. Turned out, as OCS could reasonably have expected, the banquet and catering aspects of the cafeteria cost more than was initially anticipated.

This increased cost expectation lead to the grant application dated May 12, 1999 (See EXHIBIT 7). In addition to clearly setting out for OCS’s understanding of what had occurred as to the necessity for increased funding, the grant application is important for the further providing of evidence, although it certainly was not necessary because of previous approval, of EWDC’s investment in David Capital on page 16. This grant application also make numerous references to the proposed site change about which EWDC fully believes many officials already had full and complete knowledge and raised absolutely no objection thereto. In addition, reference is made to the involvement of the Millennium Group. Unfortunately, for the cafeteria project, this grant application was denied, but remains important to the questions of what did OCS know and when did it know it. It is clear that OCS knew it all along and knew it from the very beginning.

The draft audit report refers a number of times to the language used, and the purposes of, the various entities, in their relationship to each other. Background, page 1, and Third-Party Agreement, page 5, David Capital “to hire management and operations staff for the cafeteria project”. Procurement Procedure Relative to the OCS Grant, page 8, contract with the Millennium Group “for the procurement of landscape, architecture, and design service.” Major Unapproved Programmatic or Budget Changes, page 9 “David Capital

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
hired EWCDC as the Manager and Developer of the cafeteria project.

whereas according to the Third Party Agreement EWCDC’s duties and responsibilities would include providing oversight for the development of the cafeteria project and the sale of stock, and assist in the design, documentation, and permitting of a commercial facility for the purpose of building a cafeteria” Taken in the context used, and given the working relationship of the parties, all of these uses of different language amount to exactly what the grant application (See Exhibit 5) states in so many ways. Abstract, page 5 “to develop a cafeteria style restaurant”, A. Eligibility Confirmation, page 6 “to create a community-owned cafeteria style restaurant” are just two examples.

It is also noted that the quoted section of the draft audit report from page 9 refers to "building a cafeteria" whereas the very next paragraph states that the auditors could find no evidence that OCS had approved EWCDC's building of “a cafeteria rather than make leasehold improvements to existing space”. It begs the question to ask if the auditors looked at the Third Party Agreement, of which OCS is said to have made reference in the grant program announcement (See EXHIBIT 1, page 5) before making this conclusion, while having just referred to same in the previous paragraph.

Having now completed what amounts to a line by line reputation of the draft audit report this response must give attention to what the report omitted. Three extremely important things occurred that, while mentioned in passing in the draft audit report, are dismissed as if of no consequence. These are the letter of March 29, 1999 to OCS (See EXHIBIT 8), the on site visit from OCS to EWCDC in September 1999, and the on site visit from OCS to EWCDC in November 2001. In addition to these three crucial events there is the fact that OCS failed completely in any meaningful way to assist EWCDC after the grant was made. Lastly, the visit of , Senior Deputy Director of OCS to EWCDC in August 1999. Each of these items must be examined in detail.

On March 29, 1999 , a person of some consequence in Winston-Salem and Forsyth County, North Carolina, and a Forsyth County Commissioner, as well as a member of the Board of Directors of EWCDC and of David Capital writes a letter to , Director of Community Services, Department of Health & Human Services, Administration for Children and Families re Grant #: 90EE0353 (See EXHIBIT 8) on behalf of, and in her position as, Chairperson of, EWCDC. OCS receives this letter in April 1999.

Chairperson makes several requests of OCS, but her letter is really a voice crying in the wilderness, a voice saying, help me, help me. The auditors cavalierly dismiss her, saying she did not make a specific request for approval of the David Capital investment, and consequently OCS did not approve of helping her. It is as if a drowning person yells for help but the lifeguard does not help, while he can see the person going under, and knows that a drowning is imminent, does not help because the person does not say they are drowning.

Along with her cry for help Chairperson sent the Stock Prospectus, as well as a Brochure and a Project Handout. She sent these items, along with her letter not only to , but also to and to Why?

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
The grant award letter, dated September 14, 1998 (See EXHIBIT 6) states that "The Office of Community Services Program Specialist responsible for monitoring and assisting in the programmatic activities of the project is:

* Branch Chief
Division of Community Discretionary Programs
Office of Community Services
Administration for Children and Families

It is not known if * was ever made aware of her responsibility for monitoring and assisting EWCDC in the subject project. No evidence was found that she had any involvement therein whatsoever, or that she communicated in any way with EWCDC about the project. * had the responsibility for assisting and monitoring a project which was obviously in need of both of these things, and yet, when a plea for help came from the Chairperson of EWCDC she did not even pick up the telephone and tell EWCDC that it was not her problem, or contact someone, or anything.

* advised on June 18, 2002 that she would not deny receiving the March 29, 1999 letter, but that she had no memory of receiving such a letter, and consequently had no memory of making a reply thereto. She advised that * of OCS be contacted, per the matter of locating a response to the letter of March 29, 1999, if any such response communication existed.

When contacted on June 25, 2002 * advised that she and * visited EWCDC in October/November 2001 in response to complaints from a reporter. She was unaware of there being any response to the letter of March 29, 1999 requesting assistance or of any site visit as a result of the letter. She further advised that she might not have been made aware of everything that had occurred. In addition to the right hand not knowing what the left hand is doing it must be highlighted that EWCDC's plea for help on March 29, 1999 was completely ignored for many months whereas a complaint from a newspaper reporter, with an ax to grind, was promptly responded to. It is believed by EWCDC that media complaint to which * referred is the same newspaper with which the draft was discussed (See EXHIBIT 5).

A letter from * dated February 2, 1999 (Marked EXHIBIT 30) which appears to be a form letter sent to other grantees, to EWCDC advises that she is Project Manager for the 1998 grant to EWCDC, but that she may not be with OCS after June 1999 (a telephone call to the number given in the said letter, 202/401-3446, was answered by a voice mail on June 17, 2002). No evidence can be found that * had any contact whatsoever with EWCDC other than the referenced form letter. She certainly made no reply to Chairperson * Not even a telephone call. The great experience she refers to has certainly not been that, at least not for EWCDC.

When asked about this matter on June 17, 2002, * confirmed that she was the Project manager for the EWCDC cafeteria project in April, 1999; that she received a copy of Chairperson * letter of March 29, 1999, and that she made no response whatsoever thereto. * contends that the only response whatsoever of OCS to the letter of March 29, 1999 was a visit by * to the site in Winston-Salem, NC on September 24/25, 1999, some seven months later, but that, however, there was a written response made on November 19, 1999, by *. It cannot help but be

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
noted that all hell could have frozen over between the pleas for help from the Chairperson of EWCD on March 29, 1999 and a response thereto on November 19, 1999. April, May, June, July, August, September, October, and 19 days into November.

Chairperson * likewise received not even so much as an immediate acknowledgment of her letter from * . The letter was received, that is all that happened. No evidence of assistance to, or offers of assistance to, or concern about, EWCD can be found.

The specific requests Chairperson * made were more than reasonable “a site visit”, to meet “our staff and Executive Committee [of EWCD’s Board of Directors]”, and to provide “guidance to us”, and “to discuss possible changes to our initial application”.

But Chairperson * received no response to her pleas.

Thus, EWCD, in the complete absence of any guidance, continued as it had been instructed with the cafeteria project. * did make a site visit to EWCD on September 24/25, 1999. No evidence can be found that this was actually in response to Chairperson * request of March 29, 1999. In fact, the only available evidence is that it was not, but instead a relatively routine site visit. Certainly, the letter of September 1, 1999 from EWCD to * (Marked EXHIBIT 31) welcoming the site visit makes no mention of the request of March 29, 1999. It is noted that this letter once again advises OCS of the David Capital matter and the change in the building location of the cafeteria.

* prepared a report of his two-day visit to EWCD. A copy of this report was repeatedly requested of OCS, but was not received until June 18, 2002. * advised on June 17, 2002 that the OCS files did not contain a report from *. In any event, * , in his capacity as an official of OCS, advised *, Executive Director of EWCD, verbally to the effect that all changes that EWCD had made from the grant application and/or differences between what the grant application EWCD had made from and what had, and was, actually occurring were of no consequence, and that everything was proceeding in the proper, correct, and legal fashion. * did advise that the investment by EWCD in David Capital required a third party agreement and that one should be prepared. The Third Party Agreement was thus prepared (See EXHIBIT 13) Clearly, this verbal approval of OCS to all actions of EWCD was not to be taken lightly. * attended, on September 25, 1999, the major stock sale event of David Capital. He listened to at length the details of the entire relationship of EWCD to David Capital.

Even more importantly, * prepared a Trip Report (Marked Exhibit 32) of his visit to EWCD. It could not have been more glowing in its praise of the manner in which EWCD was going about the cafeteria project and expending the grant funds. The report covered the change in the cafeteria location, the stock purchase with the grant funds, the building of a new facility, and the bookkeeping system. The report approved fully and completely of all the items that the draft audit report now cites as problems. * concludes the report with the following statement “The success story for this project has been previously mentioned but bears repeating”. It is unknown if the auditors had access to, or were aware of, this detailed report.

* In accordance with OIG-OAS Policy, the names of individuals have been deleted.
Attached to the report when it was received by EWCDC on June 18, 2002 was a two page document that appears to have been prepared by someone at OCS from the said report (Marked EXHIBIT 33). It sets out OCS's knowledge of, and approval of, the building of a facility rather than leasing space for the cafeteria. This document is critical of EWCDC only in that communication between OCS and EWCDC leaves something to be desired. One statement stands out "OCS believes that this project has great potential". It is not known if the auditors had access to, or were aware of, this document prepared sometime after September 25, 1999.

EXHIBIT 33 is important in another regard to the herein issue in that it is a written acknowledgement from OCS, that, at least no later than September 25, 1999, it had knowledge that stock had been purchases by EWCDC with OCS funds. The EXHIBIT is replete with references to the stock purchase, without any criticism, or comment whatsoever that same was in any way improper. The coup de grace in this regard is the following exact quote from the report: "The grantee [EWCDC] did provide copies to OCS of receipts for the stock purchased with OCS funds". How, in the face of this direct quoted statement the draft audit (See EXHIBIT 1), some 963 days later, can make the following two statements on page five thereof is beyond comprehension, to wit: "We found no evidence that EWCDC had requested or OCS had granted approval to use grant funds to purchase David Capital stock".... "However, we found no evidence that EWCDC had specifically requested or OCS had granted approval to use grant funds to purchase David Capital stock". The auditors might well have spent more time looking for the written approval, such as the quote from EXHIBIT 33 instead of repeating what they hoped not to find.

Also attached to the report was what appears to be another OCS document (Marked EXHIBIT 34) Once again it must be pointed out that the grant was "to develop a cafeteria-style restaurant", not just to purchase restaurant equipment. The unsigned document also makes reference to a different site for the cafeteria and the building of a facility for the cafeteria. It is not known if the auditors had access to, or were aware of, this document.

Strangely, no evidence has been located by OCS documenting the attendance of at an EWCDC sponsored luncheon in Winston-Salem, NC on August 5, 1999. It is known that he spoke to the luncheon about the David Capital stock offering to the assembled group of church and minority business community persons in attendance. It is inconceivable that he did not know that EWCDC was an investor in David Capital. It is even more inconceivable that he would make it a point to speak approvingly of what had occurred if he had not approved of the stock purchase.

Sometime prior to the fall of 2001 was named Project Officer for the grant to EWCDC at issue herein. While there had been several project officers assigned to EWCDC since the grant award of September 14, 1999, was the first to appear to take an interest in the project and to make any meaningful effort to assist EWCDC with the problems it had been, was, and, continues to face. He visited EWCDC in November 2001. This was the very first time that EWCDC was advised that the lack of specific written approvals for the things that had occurred since the grant application was...
made over four years previously could cause EWCDC problems. No truer words were ever spoken!

It is impossible to know why, after knowing what had occurred, approving of same for so long, and making little, if any effort, to assist EWCDC, OCS reversed itself, and now seeks to condemn what has occurred, even though it was a full party thereto. There have been changes in personnel, as one might expect. There have been changes in the administration of the program, there have been different standards, or the lack thereof, in the closeness of the monitoring process, there have been lapses in what one might reasonably expect the files of OCS to contain, but there is nothing to explain why what went on with knowledge and approval for over four years is now wrong.

The conclusion that the RECOMMENDATIONS section of the draft audit report makes should have been the first item on page one of the report. The entire report is couched in language attempting to justify a conclusion that appears to have been made before the audit was ever conducted. OCS, for reasons unknown, wants the $250,000 grant funds returned, and the audit, while it does not justify the conclusion, is clearly written in such a manner as to justify a conclusion already reached. As stated herein, EWCDC disagrees with this portion of the report, and through counsel, herein respectfully requests that the recommendation be corrected to read that EWCDC be required to evaluate its ability to properly control and account for Federal funds before submitting future HHS grant proposals, only.

Because nothing of this nature is played out in a vacuum and as the final audit report will become public record, as it should (even though, as previously noted, OCS saw fit to leak the draft audit report, despite its own admonition to the contrary), and as EWCDC desires to go forward with the cafeteria project, as it certainly should, seeking both public and private funding therefor, with a totally clean slate, it is appropriate to completely clear the air. It is apparent that the recommendations of the draft audit report are not in any way warranted. Therefore, it is respectfully requested that the RECOMMENDATIONS section of the draft audit report be as follows:

RECOMMENDATIONS

We recommend that OCS:

☐ Provide EWCDC with the written documentation of EWCDC’s use of grant funds to purchase stock in David Capital as already approved, and,

☐ Provide EWCDC with the written documentation of all changes in the project’s scope and budget as already approved, and

☐ Require EWCDC to evaluate its ability to properly control and account for Federal funds before submitting future HHS grant proposals.

It is noted that the draft audit report that is herein being responded to “is not to be considered final as it is subject to further review and revision” (See EXHIBIT 2). In view of this possibility it is requested that EWCDC be given an opportunity to respond to the final report if it is revised. It seems grossly unfair to be allowed to respond to the draft report and for it to be revised, we know not to what form, and to have no opportunity to respond to what the report actually ends up being. Of course, it may not work out this
way, but it is very possible that the herein response could bear no rational relationship to what the final report says. Therefore, we formally request the opportunity to review and comment on the final report when it is prepared.

If anything contained herein is unclear, or requires further clarification, please contact me.

PLEASE ACKNOWLEDGE YOUR TIMELY RECEIPT OF THE HEREFIN FORMAL RESPONSE WITH THE INCLUDED 35 EXHIBITS IMMEDIATELY UPON RECEIPT OF SAME.

Sincerely,

William T. Graham.
Attorney for East Winston Community Development Corporation
3421 Williamsborough Court
Raleigh, NC 27609
919/510-6777
wtuggtw@aol.com

CC: East Winston Community Development Corporation