
AUDIT REPORT



MICHAELSON, CONNOR AND BOUL
MANAGEMENT AND MARKETING CONTRACTOR
HUNTINGTON BEACH, CALIFORNIA

00-PH-222-1005

September 29, 2000

OFFICE OF AUDIT, MID-ATLANTIC
PHILADELPHIA, PENNSYLVANIA



Issue Date	September 29, 2000
Audit Case Number	00-PH-222-1005

TO: Engram Lloyd, Director, Homeownership Center, 3AHH

Daniel G. Temme

FROM: Daniel G. Temme, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Michaelson, Connor & Boul
Management and Marketing Contractor
Huntington Beach, California

We completed an audit of Michaelson, Connor & Boul, a Management and Marketing (M&M) contractor. This report presents the results of our audit of Michaelson, Connor & Boul's ability to manage and market FHA's single family properties. The report includes two findings with recommendations for corrective action.

Within 60 days, please provide us, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and a planned completion date; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued as a result of the audit. Note that Handbook 2000.06 REV-3 requires management decisions to be reached on all recommendations within 6 months of report issuance. It also provides guidance regarding interim actions and the format and content of your reply.

We provided a copy of this report to the auditee.

We appreciate your cooperation during the audit. We would also like to thank Michaelson, Connor & Boul's management and staff for its cooperation during the audit and commend the professionalism of its management and staff. Should you or your staff have any questions, please contact Allen Leftwich, Assistant District Inspector General for Audit at (215) 656-3401.

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Executive Summary

We completed an audit of Michaelson, Connor & Boul, a Management and Marketing (M&M) contractor. The purpose of the audit was to determine whether the M&M contractor managed and marketed FHA's single family properties according to contract requirements. Specifically, we determined whether: (1) the contractor managed properties according to HUD policies, procedures and regulations, and the terms and conditions of its M&M contract; (2) the contractor had adequate controls to ensure FHA's assets are adequately protected; and (3) contractor operations resulted in FHA accomplishing its mission and performance goals.

Consistent with FHA and contract objectives, we found MCB's monthly property sales have steadily increased, and the number of properties in its inventory has steadily declined since MCB assumed management and marketing responsibilities for the Philadelphia HOC Area-2 property inventory. However, despite these accomplishments we did identify a number of areas where improvements need to be made by the contractor. These areas are summarized below and detailed in the findings of the report.

MCB did not repair and maintain properties

MCB did not repair and maintain assigned properties according to contract requirements. Specifically, MCB did not: (1) perform timely initial inspections and property appraisals; (2) ensure property inspectors accurately reported property conditions; (3) make needed repairs or perform routine maintenance to preserve and protect properties; or (4) correct hazardous conditions. MCB relied exclusively on subcontractors and third party service providers to perform its inspection, appraisal, and property repair responsibilities, but did not adequately monitor their work to ensure it was completed according to contract provisions. As a result, the Department and the surrounding neighborhoods are at risk since poor property conditions reflect negatively on the Department's image, decrease marketability of property inventory, and in some cases threaten the health and safety of neighbors and potential buyers.

MCB did not properly process vouchers

Contrary to contract requirements, MCB processed, invoiced, and received payment from HUD for voucher items which were not properly supported, and or approved. This occurred because MCB's oversight of its invoicing and voucher payment process did not ensure: services were provided; complete and accurate files were maintained; and invoices included only eligible costs according to contract requirements. As a result, MCB received \$28,402 for duplicative and ineligible costs.

Recommendations

We recommended that MCB develop and implement a comprehensive monitoring plan over its subcontractors. At a minimum, the plan should include: (1) key contract performance requirements and outputs; (2) a methodology for conducting periodic and systematic reviews of subcontractor performance; and (3) procedures for documenting review and follow-up results. We also recommended that MCB develop and implement procedures to ensure pass-through vouchers are processed in accordance with contract specifications.

We discussed the results of our review with the contractor during the audit and at an exit conference on August 30, 2000. The contractor was also given a draft copy of the report for comment. The contractor generally agreed with the report and has reimbursed HUD for ineligible costs and taken steps to improve its operations. The contractor's written comments are contained in Appendix F and summarized, in pertinent part, elsewhere in the report.

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Abbreviations

FHA	Federal Housing Administration
HOC	Homeownership Center
HUD	U.S. Department of Housing and Urban Development
M&M	Management and Marketing
MCB	Michaelson, Connor and Boul, Inc.
OIG	Office of Inspector General
REO	Real Estate Owned

Introduction

FHA's Single Family Mortgage Insurance Program helps low and moderate income families become homeowners by reducing downpayments and limiting lender fees. Every year, however, thousands of borrowers default on their FHA-insured loans. When they default, FHA encourages lenders to work with them to bring their payments current. When they cannot do this, their homes may be sold to third parties, voluntarily conveyed to the lenders, or surrendered to lenders through foreclosure. Once lenders obtain the properties, they generally convey title to the Secretary of HUD in exchange for payment of their insurance claim.

The National Housing Act of 1934 confers on the Secretary the authority to manage, rehabilitate, rent, and dispose of properties acquired under the Single Family Property Disposition Program. Title 24, Code of Federal Regulations, part 291 implements statutory authority to manage and dispose of acquired properties. Handbook 4310.5, REV-2, dated May 17, 1994, *Property Disposition Handbook - One to Four Family Properties*, supplements the regulations. FHA's Office of Insured Single Family Housing, Asset Management Division, is responsible for administering the program.

As part of HUD's continuing reinvention efforts, FHA issued its 2020 Field Consolidation Plan for Single Family Housing and awarded contracts in March 1999 to manage and market its properties nationwide. The primary contract objectives are to ensure: (1) properties are protected and preserved, properly managed, evaluated, and marketed in a manner which produces the highest possible return to the insurance fund; (2) average losses on sales and the average time properties remain in inventory are reduced; and, (3) the overall program and the image of properties is positive.

The M&M contractor originally responsible for the Philadelphia HOC Area-2 (Ohio, Michigan, West Virginia) experienced performance difficulties and was terminated. On September 23, 1999, FHA awarded a new M&M contract to MCB and the company assumed management and marketing responsibilities for the Philadelphia HOC Area-2 property inventory.

MCB was incorporated in 1994 and its main office is located in Huntington Beach, California. Ms. Joan Heid is president. During the audit period, MCB was responsible for managing and marketing an average inventory of over 1,800 properties. As of May 31, 2000, HUD had paid MCB about \$7.8 million for its services. On May 18, 2000, HUD awarded another M&M contract to MCB to manage the Philadelphia HOC's Area-4 inventory (Maryland), formerly managed by HUD in-house staff. The Area-4 inventory significantly increased the number of properties managed by MCB to about 5,500, an increase of over 200 percent.

Audit Scope And Objectives

This audit of MCB is one in a series of audits OIG is performing regarding M&M contractor operations. Each audit is part of a nationwide assessment of FHA's ability to meet its program mission and goals while outsourcing its management and marketing activities. In addition to the

issues addressed in this report, we identified other matters which will be addressed in a nationwide report. For example, the percentage of property sales to owner occupants declined significantly during the audit period. However, the primary cause for the decline is not directly attributable to the contractor.

The audit objectives were to determine if: (1) the contractor managed properties according to HUD policies, procedures and regulations, and the terms and conditions of its M&M contract; (2) the contractor had adequate controls to ensure FHA's assets are adequately protected; and (3) contractor operations resulted in FHA accomplishing its mission and performance goals.

To meet our objectives, we:

- Interviewed MCB and HOC officials;
- Reviewed a judgmental sample of 30 active, 18 closed, and 15 held-off-market property case files;
- Inspected a judgmental sample of 36 properties;
- Reviewed a judgmental sample of contractor payment vouchers;
- Obtained direct SAMS access and queried financial and property inventory data tables;
- Analyzed all pass-through costs paid during the audit period;
- Reviewed the contractor's policies and procedures, and observed its operations; and,
- Analyzed inventory and sales trends.

We assessed management controls over: (1) property preservation and protection; (2) billings to HUD for services; (3) property sales; (4) property appraisals; (5) review of sales closing documents; and (6) subcontracting.

Our audit was performed from April through July 2000 and generally covered the activities from contract inception on September 23, 1999 through April 1, 2000. We expanded our scope to other periods as necessary to accomplish the audit objectives.

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

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MCB Did Not Adequately Maintain Properties

MCB did not repair and maintain assigned properties according to contract requirements. Specifically, MCB did not: (1) perform timely initial inspections and property appraisals; (2) ensure property inspectors accurately reported property conditions; (3) make needed repairs or perform routine maintenance to preserve and protect properties; or (4) correct hazardous conditions. MCB relied exclusively on subcontractors and third party service providers to perform its inspection, appraisal, and property repair responsibilities, but did not adequately monitor their work to ensure it was completed according to contract provisions. As a result, the Department and the surrounding neighborhoods were at risk since poor property conditions reflect negatively on the Department's image, decrease marketability of property inventory, and in some cases threaten the health and safety of neighbors and potential buyers.

Contract Requirements to Secure and Maintain Properties

Section C-2 of MCB's contract requires it to perform an initial inspection of newly assigned properties within 24 hours of assignment and to take all necessary actions to preserve, protect, and maintain each property in a presentable condition at all times. Section C-2 also requires MCB to obtain an appraisal of each property no later than 10 days after title is conveyed to HUD.

MCB Did Not Perform Timely Property Inspections and Appraisals

To determine if inspections and appraisals were performed in a timely manner, we randomly selected 30 active property case files, and analyzed inspection reports and other relevant documentation. Of the 30, 12 properties were originally assigned to the former M&M contractor and were inherited by MCB. Because these files generally were not properly maintained, we did not include their results in our analyses of the cases fully processed by MCB.

Our review of case files for the 18 newly acquired properties disclosed that MCB did not inspect 10 of the properties within 24 hours of assignment as required by contract provisions. Inspections ranged from 1 to 23 days late. Our review also showed that 11 of 18 appraisals were not obtained within prescribed time frames. Delays ranged from 1 to 70 days. Although MCB was aware of contract requirements, they did not effectively monitor subcontractors assigned to perform inspection and appraisal services to ensure timely completion. Timely inspections are critical to ensure properties are properly secured and protected and that potential hazards and needed repairs are

identified and corrected. Additionally, obtaining timely appraisals ensures properties are promptly listed for sale.

Inspections Did Not Identify Property Deficiencies

In order to evaluate the effectiveness of MCB’s property inspection and maintenance procedures, we performed 36 detailed inspections of randomly selected properties in Michigan and Ohio and compared our results to the most recent inspections performed by MCB and its subcontractors. Since 9 of the 36 properties we inspected were scheduled for demolition, occupied, or entry could not be obtained, we did not include these inspections in our comparative analysis. We found MCB’s inspections did not identify evident deficiencies in any of the 27 remaining properties. The number and types of deficiencies are summarized below and detailed in Appendix B.

<u>Description</u>	<u>Number of Deficiencies</u>
Interior/Exterior Debris	12
Lawn/Shrubbery Not Maintained	14
Evidence of Roof Leaks	10
Structural Damage	5
Vandalism	19
Defective Interior/Exterior Paint	20
Missing Proper Sign	11
Emergency Maintenance Items	17
Interior/Exterior Hazardous Conditions	19

As shown above, MCB’s inspections did not identify deficient property conditions, and routine repair and maintenance needs required by contract specifications were not performed. Additionally, our inspections identified hazardous conditions that were not detected and immediately corrected as prescribed by contract requirements. The number of unidentified hazardous safety deficiencies by type is as follows:

<u>Hazardous Condition</u>	<u>Number of Deficiencies</u>
Unsafe Flooring	7
Exposed Electrical Wires or Circuits	11
Missing or Broken Handrails	9
Broken or Unsafe Steps	3
Unsafe Garage Door	1
Broken Glass	14

The M&M contract specifies that MCB will routinely inspect and take all actions necessary to preserve, protect, and maintain each property. The contract also clearly specifies each of the routine and hazardous deficiencies identified in the charts above should have been repaired by MCB.

See Appendix C for selected photographs of hazardous conditions and inspection deficiencies.

* * * * *

We attributed MCB’s property inspection, appraisal, and repair/maintenance difficulties to not establishing and implementing a formal, comprehensive subcontractor monitoring plan. MCB fulfilled its inspection, appraisal, and property repair responsibilities exclusively through subcontractors and third party service providers. Although MCB had office locations in each state staffed with in-house personnel to monitor work performed by subcontractors, subcontract monitoring was informally managed through spot inspections, and electronic and telephone contact with subcontractors and MCB main office personnel. MCB’s field office personnel lacked a structured approach for enforcing MCB contract responsibilities through its subcontracting network and, as evidenced by our inspection results, could not adequately protect HUD’s interests. MCB needs to develop a comprehensive monitoring plan that identifies the performance outputs and describes the inspection methodology in sufficient detail so it can serve as the basis for conducting systematic and structured evaluations of subcontractor performance.

Auditee Comments

Inspection and Appraisal Timeliness

MCB acknowledged that additional improvements were needed to ensure property inspection, and appraisal services were provided by its subcontractors within prescribed contract time frames. To improve its M&M contract operations, MCB has: (i) terminated their relationship with subcontractors who have consistently demonstrated an inability to complete assigned tasks within contract limits; (ii) increased its in-house oversight responsibility and no longer subcontracts with 3rd parties to perform monitoring functions; and (iii) made changes to its inspection and appraisal ordering process to ensure timely and effective performance.

Comparative Inspection Analyses

MCB generally agreed that property inspection and repair and maintenance procedures needed improvement and have instituted procedural changes that increased in-house inspection frequency and subcontractor oversight. MCB disagreed, in some instances, with the OIG's interpretation of contract inspection and repair requirements and cited examples relating to interior water damage, defective paint surfaces, posting of signs, and vandalism. MCB stated contract terms do not require the disclosure and repair of interior water damage caused by roof leaks that were repaired prior to being assigned to the M&M property inventory. While MCB agreed that the defective paint surfaces identified by the OIG inspections had merit, they should not be considered a performance deficiency since MCB generally does not make these repairs until just prior to the sale of the property. Concerning the sign posting deficiencies noted by the OIG, MCB stated that their records indicated that the proper signs were posted. Regarding apparent vandal damage identified by the OIG, MCB stated in some cases its records show that MCB had previously identified and repaired damage caused by vandals and indicated repeated acts of vandalism on the same property are common.

OIG Evaluation of Auditee Comments

MCB is to be commended for its commitment towards developing and implementing procedural changes to improve its inspection, appraisal, and repair and maintenance services. Additionally, we have taken MCB responses into consideration and made appropriate revisions to the finding. Regarding the areas of disagreement we respond as follows:

Comparative Inspection Analyses

As stated in the finding, we performed detailed property inspections of randomly selected properties and compared our results with the most recent inspections performed by MCB and its subcontractors. The comparative analyses of the differences between the two inspections are detailed in the finding and in Appendix B. The fundamental essence of the problem is the fact that we found property conditions that were not identified, disclosed, and when appropriate, repaired as a result of MCB's property inspection process. Contrary to MCB's stated position, contract terms require that detailed initial and periodic inspections be performed to document the property's condition without regard to the nature and timing of prior repairs. Regarding MCB's comments concerning the defective paint, sign posting, and vandalism examples, our results clearly showed that MCB's inspection documentation failed to identify and disclose these conditions. Unless inspections are properly conducted and accurately documented in accordance with contract provisions, there are minimal assurances that properties will be adequately protected and preserved, hazardous conditions remedied, and HUD's interests will be protected.

Recommendations

We recommend you:

- 1A. Require MCB to develop and implement a comprehensive monitoring plan over its subcontractors. At a minimum, the plan should include:
 - key contract performance requirements and outputs (inspection, appraisal, and repair/maintenance)
 - a methodology for conducting periodic and systematic reviews of subcontractor performance

- procedures for documenting review and follow-up results
- 1B. Once implemented, closely monitor MCB's subcontractor monitoring initiatives to ensure that inspection, related repair and maintenance, and appraisal services are provided in accordance with contract requirements.

MCB Needs To Improve Its Voucher Processing To Comply With Contract Requirements

Contrary to contract requirements, MCB processed, invoiced, and received payment from HUD for voucher items which were not properly supported, and/or approved. This occurred because MCB's oversight of its invoicing and voucher payment process did not ensure services were provided, complete and accurate files were maintained, and invoices included only eligible costs according to contract requirements. As a result, MCB was paid \$28,402 for duplicative and ineligible costs.

Contract Payment Requirements

All costs of performance under the M&M contract are to be at the expense of the contractor, unless otherwise specifically identified as a pass-through cost. Section C-4 (III)(A) of the M&M contract defines a pass-through cost as an actual out-of-pocket expense incurred and paid by the contractor that is not deemed a contractor's expense such as utility bills and homeowner association fees which are cost-reimbursable as an allowable pass-through cost. Because the inventory managed by the former contractor (transitional inventory) was generally in a state of disrepair, special contract modifications (Exhibit 16) were created that allowed MCB to claim as pass-through costs, expenses such as debris and defective paint removal, and securing the property for these transitional properties that normally would be borne by MCB. Exhibit 16 specifies that these exception pass-through costs require written bids and GTR approval based upon certain dollar thresholds.

Section G-4 (IV)(G) of the M&M contract states that pass-through costs will be billed monthly and must be supported with original documentary evidence, such as invoices from vendors, to support the cost of each item for which reimbursement is requested. Invoices must indicate the name of the vendor, service dates, amount per type of service, and a sufficiently detailed description. Pass-through reimbursements must be submitted on Form SAMS-1106, Invoice Transmittal, and properly coded to identify the item or service.

Section C-4 (III) (B) and (C) of the M&M contract states that MCB will be reimbursed for the actual cost of eligible pass-through services that are paid to the billing parties and that no administrative costs are to be added. Payments made by MCB for penalties, fees, or interest incurred by MCB due to late payment to other parties are unallowable costs.

Pass-through Costs Were Not Properly Processed

We judgmentally selected and reviewed 26 pass-through items (17 repair/maintenance and 9 miscellaneous expense items) submitted on MCB’s February and March 2000 vouchers. Our review showed that pass-through costs were not always properly supported, approved, and processed. As noted below, we found deficiencies in nine categories. Please note, not all categories were applicable to each of the 17 repair and maintenance items selected. This is reflected in the chart below.

<i>Deficiencies Noted</i>	<i>Number of Occurrences</i>
Repair and Maintenance Items	
MCB invoiced and HUD paid ineligible costs associated with post transitional properties	4 of 4
MCB invoices consisted of summary spreadsheets which did not identify the vendor, date of service, nor detail the unit of measure and quantity.	17 of 17
Bids were not maintained in property case files, submitted with invoices, or submitted to the GTR when required. When some bids were subsequently provided one appeared to be contrived, and in another case the winning bidder had prior knowledge of competing bids.	7 of 7
Supporting documentation to include <u>invoices</u> and <u>photographs</u> was not always maintained in the 12 property case files provided for our review.	9 of 12 invoices 7 of 12 photos
GTR approval was not obtained when required.	6 of 6
Pass-through costs were processed with the wrong description post code; therefore, expenses were incorrectly reported to HUD and HUD could have paid for otherwise ineligible voucher items.	5 of 10
MCB could not locate the property case file for our review.	5 of 17
Miscellaneous Expense Items	
Utility, Homeowner Association (HOA), and miscellaneous bills were not consistently date received stamped; therefore, we were unable to determine whether late payment fees were an allowable cost.	4 of 9

Duplicative, Ineligible, and Unreasonable Pass-through Costs

Because of the variety and significance of the deficiencies we identified in our initial sample of pass-through items, we expanded our review to identify duplicative and ineligible pass-through costs on a larger scale. Using computer-assisted auditing techniques (CAAT's), we analyzed \$1.25 million of pass-through costs paid from September 1999 (contract inception) through March 2000 and determined MCB was paid \$18,839 and \$11,433 in duplicate invoices¹ and ineligible costs, respectively. Details of this review follow.

Duplicate Payments

Using CAAT's we identified 100 duplicate payments valued at \$18,839. In some cases, the same invoice was paid three times. We found MCB accounting personnel had already identified and reimbursed HUD \$5,181 for 17 of the duplicate payments which resulted from a HUD payment error. Due to time constraints we selected the 2 largest of the remaining 83 duplicate payments valued at \$3,572 and determined MCB submitted these invoices in error due to weak invoicing and payment processing controls. MCB took immediate action and promptly reimbursed HUD \$8,753 for the 19 duplicate payments. The remaining 81 duplicative payments totaling \$10,086 should be reviewed and reimbursed to HUD as appropriate. Appendix D contains a detailed chart of all duplicate payments and their status at the end of the audit.

Ineligible Items

MCB invoiced and was reimbursed \$11,433 for 33 items during the review period that were not eligible as a pass-through expense as stipulated in the contract provisions. In these cases, MCB accounting personnel treated these costs as if they were associated with the inventory assigned to the former contractor and eligible under the special exceptions. However, because MCB failed to recognize that these properties were newly acquired, they inappropriately invoiced HUD for these items. When brought to their attention, MCB agreed with our assessment and promptly initiated actions to repay the \$11,433 in ineligible costs. In order to preclude future occurrences, MCB needs to strengthen its pass-through invoice processing procedures by ensuring that pass-through cost exceptions are only applied to properties inherited from the former M&M

¹ Our analyses identified a duplicate payment when the invoiced amount, property case number, and description code all were the same.

contractor. The ineligible pass-through expenses are detailed in Appendix E.

* * * * *

When made aware of our results, MCB initiated immediate procedural changes to better document pass-through costs and to ensure more accurate processing.

Auditee Comments

MCB indicated that it has developed and implemented additional management and accounting controls to ensure vouchers are processed in accordance with contract provisions. Invoicing procedures have been revised to require the application of a step-by-step process to ensure vouchered costs are eligible and properly supported, approved, and non-duplicative. Additionally, MCB performed a detailed review of the duplicative costs questioned in the finding. Of the 72 unresolved items valued at \$10,086.31, MCB determined that 59 were duplicative and promptly reimbursed HUD \$8,215.53. MCB's research further disclosed that 13 line items valued at \$1,870.78 were associated with recurring home owners' association fees or were correctly processed and were not duplicative.

OIG Evaluation of Auditee Comments

We concur with MCB's duplicate cost analyses and commend their prompt response in improving vouchering procedures, and validating and reimbursing HUD \$8,215.53 for duplicative pass-through costs. Additionally, we have taken MCB's responses regarding questionable pass-through costs into consideration and made appropriate revisions to the finding.

Recommendation

We recommend you:

2A. Require MCB to develop and implement procedures to ensure pass-through vouchers are processed in accordance with contract specifications. At a minimum, procedures should be developed to ensure pass-through expenses are:

- invoiced only for allowable services and items

- reimbursed only for the actual amount of the service and do not include additional administrative fees
- supported with detailed invoices and comparable before and after photographs
- awarded competitively, when appropriate
- documented fully and supported in property case files, including invoices, photographs, and bids, when appropriate
- approved by the GTR, when appropriate
- coded properly
- stamped with date received

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Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the organizational plan, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the process for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Significant Controls

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

- performing timely inspections and appraisals
- repairing and maintaining properties
- reporting accurate property conditions
- monitoring and oversight of subcontractors
- processing voucher payments
- complying with invoicing requirements, including making sure invoices included only allowable costs

We assessed all of the relevant controls identified above.

Significant Weaknesses

It is a significant weakness if management controls do not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

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

- MCB did not perform timely inspection and appraisal services, and did not adequately maintain properties
- MCB did not adequately process and invoice payment vouchers

These weaknesses are detailed in the findings in this report.

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Follow Up On Prior Audits

This is the first audit of Michaelson, Connor and Boul by HUD's Office of Inspector General.

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Schedule Of Questioned Costs

<u>Finding Number</u>	<u>Type of Questioned Costs</u>
2	<u>Ineligible</u> 1/ \$28,402 2/

- 1/ Ineligible costs are costs charged to a HUD program or activity that the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations.
- 2/ MCB reimbursed HUD for ineligible costs.

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Summary of Inspection Deficiencies

LINE	Case Number	Debris *	Lawn Uncut	Evidence of Roof Leak	Structural Damage	Vandalism	Defective Paint *	Sign Not Posted	Emergency Maintenance Items	Hazardous Conditions *
DETAILED INTERIOR-EXTERIOR INSPECTIONS										
1	261-387952	X	X	X			X		X	X
2	261-498824				X	X	X	X		
3	261-538521			X		X	X			
4	261-540913		X		X	X	X		X	
5	261-608767	X	X			X		X	X	X
6	261-638906						X			
7	261-646304	X	X	X		X	X		X	X
8	261-653344		X			X	X	X	X	X
9	261-653929		X			X	X			
10	261-659307	X	X			X	X	X	X	X
11	261-665023		X	X		X	X		X	X
12	261-702594	X	X	X		X	X			X
13	412-209985						X	X		X
14	412-238835		X	X	X	X			X	X
15	412-243319					X		X	X	X
16	412-304609	X	X		X				X	X
17	412-305483					X				
18	412-367738			X		X	X			X
19	412-368699							X		
20	412-372093	X		X		X	X	X	X	X
21	412-372302	X	X	X		X	X		X	X
22	412-372609		X		X			X		X
23	412-375628	X	X	X		X	X		X	X
24	412-380519	X					X	X	X	X
25	412-389175	X				X	X		X	
26	412-397739						X	X	X	X
27	412-364956	X				X	X		X	X
TOTAL DEFICIENCIES		12	14	10	5	19	20	11	17	19
PERCENT DEFICIENT		44%	52%	37%	19%	70%	74%	41%	63%	70%
PROPERTY INTERIOR NOT INSPECTED DUE TO OCCUPANCY OR UNABLE TO OPEN LOCK **										
1	261-376523	X	X				X	X		X
2	261-463489	X	X						X	X
3	261-585343									
4	261-645993									
5	412-263917	X	X			X	X	X		X
6	412-313060		X					X		
PROPERTIES SCHEDULED FOR DEMOLITION **										
1	261-497947									
2	261-519695									
3	412-237212									
36 TOTAL INSPECTIONS										
X = Deficiency found per OIG inspection and not identified on MCB inspection										
* Includes both interior and exterior deficiencies										
** Full interior/exterior inspections were not feasible; therefore, noted deficiencies were not included in the results.										

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Selected Photographs of Hazardous Conditions and Inspection Deficiencies



FHA Case Number 412-397739 Cleveland, Ohio OIG Inspection May 31, 2000

Broken Floorboards - Top View



FHA Case Number 412-397739 Cleveland, Ohio OIG Inspection May 31, 2000

Broken Floorboards Bottom View



FHA Case Number 412-238835 Cleveland, Ohio OIG Inspection June 1, 2000

Ceiling Damage from Water Leak



FHA Case Number 412-238835 Cleveland, Ohio OIG Inspection June 1, 2000

Missing/Broken Steps, Yard Not Maintained



FHA Case Number 412-304609 Cleveland, Ohio OIG Inspection June 1, 2000

Exposed Electrical Circuits and Wires



FHA Case Number 261-376523 Detroit, Michigan OIG Inspection May 25 2000

Broken/Missing Window



FHA Case Number 412-372302 Cleveland, Ohio OIG Inspection May 31, 2000
Uncovered Hole in Floor



FHA Case Number 261-463489 Detroit, Michigan OIG Inspection May 22, 2000
Exposed Electrical Circuits and Deteriorated Siding



FHA Case Number 412-372093 Cleveland, Ohio OIG Inspection June 1, 2000

Defective Exterior Paint Surfaces



FHA Case Number 412-372093 Cleveland, Ohio OIG Inspection June 1, 2000

Exposed Electrical Wires



FHA Case Number 261-608767 Detroit, Michigan OIG Inspection May 22, 2000
Ceiling Damage from Water Leak



FHA Case Number 412-237212 Cleveland, Ohio OIG Inspection June 2, 2000
Debris Under Front Porch

Duplicate Pass-Through Costs

CASE NUMBER	TRANSMITTAL NUMBERS	DESCRIPTION CODE	DUPLICATE PAYMENT	REIMBURSED BY MCB	NOTES	UNRESOLVED AMOUNT	
262	033170	00022, 00041	UT	\$45.00	\$45.00	1	\$0.00
262	042929	00219, 000506	BR	\$180.00			\$180.00
571	047852	00022, 00041	TX	\$437.41	\$437.41	1	\$0.00
571	052726	00413, 00059	MM	\$1,212.37	\$1,212.37	2	\$0.00
262	076711	00364, 00506	BR	\$180.00			\$180.00
412	097708	00511, 00636	BR	\$42.00			\$42.00
262	102907	00022, 00041	UT	\$45.00	\$45.00	1	\$0.00
262	106058	00219, 00380	BR	\$180.00			\$180.00
262	113382	00380	CD	\$180.00			\$180.00
413	117550	00254, 00378, 00511	CD	\$60.00		3	\$60.00
413	126147	00254, 00378	CD	\$30.00			\$30.00
413	127073	00254, 00378	CD	\$30.00			\$30.00
413	139045	00254, 00378, 00511	CD	\$60.00		3	\$60.00
413	157411	00254, 00378, 00511	CD	\$60.00		3	\$60.00
411	192519	00142, 00224	CF	\$110.00			\$110.00
411	192519	00022, 00041	CF	\$120.00	\$120.00	1	\$0.00
412	234689	00469, 00635	BR	\$180.00			\$180.00
412	253426	00378, 00396	CD	\$384.00			\$384.00
263	255706	00219, 00364	BR	\$30.00			\$30.00
411	256879	00022, 00041	CF	\$381.21	\$381.21	1	\$0.00
263	257041	00022, 00041	UT	\$105.70	\$105.70	1	\$0.00
413	257119	00215, 00632	CD	\$30.00			\$30.00
411	257146	00248, 00395	CD	\$480.00			\$480.00
413	259980	00224, 00329	UT	\$6.13			\$6.13
263	262732	00178, 00243	BR	\$180.00			\$180.00
411	262874	00224, 00329	UT	\$53.43			\$53.43
413	264626	00215, 00511	CD	\$30.00			\$30.00
411	264724	00022, 00041	CF	\$654.26	\$654.26	1	\$0.00
411	264956	00120	BR	\$180.00			\$180.00
412	267331	00377, 00469	BR	\$180.00			\$180.00
413	268903	00215, 00511	CD	\$30.00			\$30.00
263	268954	00499, 00640	CF	\$136.44			\$136.44
411	269336	00022, 00041	CF	\$780.00	\$780.00	1	\$0.00
412	273911	00469, 00630	BR	\$180.00			\$180.00
413	277494	00142, 00224	CF	\$94.00			\$94.00
413	277494	00241, 00499, 00640	CF	\$198.00		3	\$198.00
413	277494	00022, 00041	CF	\$203.00	\$203.00	1	\$0.00
411	278684	00583, 00640	CF	\$56.34			\$56.34
411	278684	00022, 00041	CF	\$218.80	\$218.80	1	\$0.00
413	282778	00022, 00041	CF	\$475.00	\$475.00	1	\$0.00
412	283707	00510, 00511	DF	\$144.00			\$144.00
413	284751	00215, 00511	CD	\$30.00			\$30.00

Appendix D

CASE NUMBER	TRANSMITTAL NUMBERS	DESCRIPTION CODE	DUPLICATE PAYMENT	REIMBURSED BY MCB	NOTES	UNRESOLVED AMOUNT	
413	285184	00142, 00224	CF	\$85.00		\$85.00	
413	285184	00022, 00041	CF	\$455.00	\$455.00	1	\$0.00
413	285259	00384, 00499, 00640	CF	\$164.00		3	\$164.00
413	285585	00022, 00041	CF	\$455.00	\$455.00	1	\$0.00
412	289583	00254, 00501, 00215	BR	\$60.00		3	\$60.00
413	290687	00022, 00041	CF	\$225.22	\$225.22	1	\$0.00
413	298069	00215, 00511	CD	\$30.00			\$30.00
413	302074	00329, 00457	WT	\$220.97			\$220.97
413	307643	00215, 00254, 00511	CD	\$60.00		3	\$60.00
413	312234	00022, 00041	CF	\$336.00	\$336.00	1	\$0.00
412	313636	00243, 00635	BR	\$180.00			\$180.00
412	317963	00215, 00513	CD	\$120.00			\$120.00
412	321961	00022, 00041	UT	\$242.23	\$242.23	1	\$0.00
412	349977	00254, 00378	BR	\$30.00			\$30.00
412	349977	00254, 00378	CD	\$2,359.20	\$2,359.20	2	\$0.00
412	358171	00378, 00396	BR	\$42.00			\$42.00
412	358171	00378, 00396	CD	\$66.00			\$66.00
412	363185	00583, 00640	CF	\$125.00			\$125.00
412	380199	00502, 00635	BR	\$180.00			\$180.00
412	380280	00377, 00507	BR	\$180.00			\$180.00
412	382891	00380, 00469	BR	\$180.00			\$180.00
261	387952	00380	BR	\$180.00			\$180.00
412	388578	00384, 00499, 00640	CF	\$166.00		3	\$166.00
412	388891	00366, 00635	BR	\$180.00			\$180.00
412	389560	00457, 00499, 00640	CF	\$166.00		3	\$166.00
261	389849	00179, 00380	BR	\$180.00			\$180.00
412	391116	00378, 00394	CD	\$162.00			\$162.00
412	393514	00623, 00635	BR	\$180.00			\$180.00
412	398149	00254, 00378	CD	\$30.00			\$30.00
261	426151	00179, 00487	BR	\$180.00			\$180.00
261	489372	00163, 00502	BR	\$180.00			\$180.00
261	498942	00179, 00397	BR	\$180.00			\$180.00
261	515291	00179, 00364	BR	\$180.00			\$180.00
261	518531	00123, 00506	BR	\$180.00			\$180.00
261	523097	00179, 00364	BR	\$180.00			\$180.00
261	551302	00179, 00364	BR	\$180.00			\$180.00
261	577702	00179, 00506	BR	\$180.00			\$180.00
261	597474	00365, 00627	BR	\$180.00			\$180.00
261	632928	00190	BR	\$180.00			\$180.00
261	636452	00123, 00488	BR	\$180.00			\$180.00
261	645099	00329, 00457	IF	\$150.00			\$150.00
261	645993	00123, 00488	BR	\$180.00			\$180.00
261	649553	00190, 00507	BR	\$180.00			\$180.00
261	655111	00022, 00041	MI	\$2.00	\$2.00	1	\$0.00
261	657975	00583, 00640	IF	\$225.00			\$225.00

CASE NUMBER		TRANSMITTAL NUMBERS	DESCRIPTION CODE	DUPLICATE PAYMENT	REIMBURSED BY MCB	NOTES	UNRESOLVED AMOUNT
261	664980	00243, 00502	BR	\$30.00			\$30.00
261	669821	00183, 00507	BR	\$180.00			\$180.00
261	669821	00183, 00507	CD	\$300.00			\$300.00
261	688057	00380, 00623	BR	\$180.00			\$180.00
		TOTALS		\$18,838.71	\$8,752.40		\$10,086.31

- NOTES:
- 1) DUPLICATE PAYMENT MADE IN ERROR BY HUD AND REIMBURSED BY MCB
 - 2) DUPLICATE INVOICE PROCESSED BY MCB. HUD REIMBURSED WHEN NOTIFIED BY OIG
 - 3) MCB INVOICED ITEM 3 TIMES, DUPLICATING PAYMENT TWICE

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Ineligible Pass-Through Expenses

CASE NUMBER	DATE ACQUIRED	DESCRIPTION	TRANSMITTAL	LINE	AMOUNT
261 656144	10/23/99	CLEAN-UP & DEBRIS REMOVAL	00142	12	\$111.17
411 247573	9/30/99	APPRAISAL NEEDED FOR FILE	00266	4	\$300.00
411 252345	10/27/99	SECURE PROPERTY	00378	16	\$30.00
411 267944	10/1/99	CLEANING	00253	2	\$810.00
411 272993	11/13/99	CLEAN-UP	00217	103	\$33.60
411 278684	10/28/99	CLEAN-UP	00217	116	\$600.00
411 278684	10/28/99	SECURE PROPERTY	00217	115	\$180.00
412 367468	10/14/99	CLEANING	00488	24	\$60.00
412 367468	10/14/99	SECURE PROPERTY	00488	23	\$180.00
412 367559	10/27/99	CLEANING	00393	2	\$1,563.60
413 250988	1/8/00	CLEANING	00378	67	\$466.80
413 250988	1/8/00	SECURE PROPERTY	00378	66	\$42.00
413 283008	3/29/00	CLEAN-UP	00215	150	\$504.00
413 283008	3/29/00	SECURE PROPERTY	00215	149	\$30.00
413 290313	10/9/99	CLEAN-UP & DEBRIS REMOVAL	00137	5	\$540.00
413 290313	10/9/99	MISCELLANEOUS INCOME	00137	4	\$264.00
413 298723	12/23/99	CLEAN-UP & DEBRIS REMOVAL	00634	1	\$30.00
413 304589	10/1/99	CLEAN-UP & DEBRIS REMOVAL	00132	26	\$432.00
413 304589	10/1/99	BOARD-UP/SECURE	00132	25	\$288.00
571 047676	12/1/99	CLEANING	00504	1	\$48.00
413 111102	01/27/2000	SECURE PROPERTY	00511	60	\$126.00
413 111102	01/27/2000	CLEANING	00511	61	\$360.00
413 111102	01/27/2000	DEFECTIVE PAINT	00511	62	\$150.00
413 146301	01/27/2000	SECURE PROPERTY	00511	65	\$198.00
413 146301	01/27/2000	CLEANING	00511	66	\$990.00
413 146301	01/27/2000	DEFECTIVE PAINT	00511	70	\$210.00
261 587407	01/27/2000	SECURE PROPERTY	00626	1	\$180.00
261 587407	01/27/2000	CLEANING	00626	2	\$720.00
261 420491	01/27/2000	SECURE PROPERTY	00627	1	\$186.00
261 420491	01/27/2000	CLEANING	00627	2	\$1,014.00
412 252020	01/27/2000	SECURE PROPERTY	00635	4	\$180.00
412 252020	01/27/2000	CLEANING	00635	5	\$294.00
412 252020	01/27/2000	DEFECTIVE PAINT	00635	6	\$312.00
				TOTAL	\$11,433.17**

** MCB has recognized the ineligibility of these costs and has initiated actions to reimburse HUD \$11,433.17.

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Auditee Comments

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September 22, 2000

BY FACSIMILE AND FEDERAL EXPRESS

Daniel G. Temme
District Inspector General for Audit
U.S. Dept. of Housing & Urban Development
100 Penn Square East
Wanamaker Bldg., Suite 1005
Philadelphia, Pennsylvania 19107-3380

Re: Response of Michaelson, Connor & Boul to Draft IG Audit Report
HUD IG Audit Case No. 00-PH-222-1005

Dear Mr. Temme:

I represent Michaelson, Connor and Boul (MCB) with respect to its government contract issues and other general legal matters. In this capacity, I am writing on behalf of MCB to respond to the issues raised in the above-cited draft audit report issued following the HUD IG audit of MCB performance of its Management and Marketing (M&M) contract in the Philadelphia HOC Area – 2, defined as Michigan, Ohio and West Virginia.

Summary. During the course of this audit and the exit interview conducted with MCB personnel, HUD IG Auditor, Mr. Clifford Cole, effectively communicated to MCB the audit findings, and provided the requested working papers and documentation with which MCB was able to investigate the circumstances surrounding each issue raised.

From this review, MCB determined that accounting or payment processing errors on the part of HUD were responsible for the majority of the duplicate payments and voucher problems found, and has rectified the errors resulting from inadequate MCB accounting controls. The MCB internal procedures pertaining to subcontractor oversight responsible for untimely inspections, appraisals or inaccurate pass through invoicing have been addressed by new management controls added to existing internal MCB operating procedures. As of this date, MCB has implemented all of the management changes intended to remedy the problems originating from MCB errors or oversight, and the required payments to HUD have been made in full. Finally, MCB has confirmed that the audit finding responsible for the bulk of the payments deemed ineligible, \$104,236 – roughly 83 % of the \$125,757 costs questioned in this audit – will be rescinded due to the Contracting Officer's determination as reasonable the pass through expenses originally deemed unsupported by the auditor.

MCB specifically responds to each of the audit issues as follows:

Questioned Costs. As the IG recognized in its audit report, during the audit period, MCB was responsible for managing and marketing an average inventory of over 1800 properties, for which it was paid more than \$7.8 million for these services. Draft IG Audit Report, page 1. Following a four-month audit of MCB

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management controls, the IG identified a total of \$125,757 in questioned costs during the period in question – approximately 1.6% of the total payments received. The questioned items were divided into three categories: a) \$18,839 in duplicate pass-through invoices; b) \$11,433.17 in ineligible pass-through expenses; and c) \$104,238 in unresolved costs deemed to be unsupported, pending review by the Contracting Officer. MCB has determined that, of these questioned costs, only \$19,648.70 of the questioned costs were the result of MCB error [all \$11,433.17 of the ineligible expenses included in b) above, plus \$8,215.53 of the \$18,839 in invoices deemed to be duplicates in a) above]. This figure constitutes just 15% of the costs questioned by the auditor, and less than 1/2 of one percent of the \$7.8 million in payments processed during the audit period. To date, all payments due to HUD from MCB for these items have been made. MCB's invoice review made the following disclosures:

Duplicate Pass-Through Invoices. In its Draft IG Audit Report, the auditor cited 91 instances of errors resulting in the improper payment by HUD of MCB invoices under the contract. Draft IG Audit Report, Appendix D. In fact, MCB's careful review of these invoices has revealed that the bulk of these invoices were either properly prepared by MCB or improperly paid twice by HUD. And, where the invoices questioned were the result of MCB error, the duplicate payments have been promptly and completely repaid. As you will see from the annotated version of Appendix D, attached hereto as Exhibit A, we have numbered and categorized every invoice according to its repayment status and/or MCB's rationale for the invoices to be deemed proper:

- Items numbered 15, 32, 35, 36, 38, 43, 45, 60, 65, and 67 constitute 24 invoices that are not, in fact, duplicate invoices, but represent invoices to HUD for the proper payment of Home Owners' Association (HOA) fees due for different months associated with the properties at issue. It is easy to see how duplicate invoices for the same amount for the same property and for the same code -- HOA fees -- could be misconstrued as a duplicate payment, when, in fact, the charges were for different months. As such, these invoices and payments were proper, and need not be repaid.
- Items numbered 8, 9, and 68 constitute invoices that MCB deems to be correct billing for allowable charges, and sees no basis for the conclusion that the charge was an improper duplicate of any other.
- Items numbered 8 and 47 constitute invoices deemed to be duplicates by the auditor as submitted twice on the noted transmittals, but which MCB's transmittal copies do not indicate any billing for duplicate charges. Absent evidence to the contrary, MCB deems these invoices and payments to be proper.
- Items numbered 1, 3, 7, 16, 20, 21, 28, 33, 37, 39, 40, 44, 46, 48, 52, 55, and 86 constitute invoices that were proper, and submitted just once by MCB, but which HUD improperly paid to MCB twice. It is important to note that HUD's error in improperly paying these invoices twice was an error first noted by MCB accounting personnel, and immediately repaid at the time of HUD's error -- long before the IG audit. MCB contends that the IG Final Audit Report should clearly reflect the fact that the MCB accounting controls in place -- even prior to the system improvements implemented within the last six months -- were adequate to promptly report and remedy these invoice and accounting errors made by HUD alone.
- Items numbered 2, 4-6, 10-14, 17-19, 22-27, 29-31, 34, 41, 42, 47, 49-51, 53, 54, 56-59, 61-64, 66, 69-85, and 87-91 constitute invoices that MCB agrees were issued twice by mistake and for which repayments have been transmitted to HUD within the last 30 days. See check copies

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attached as Exhibit B. During the course of the audit, the IG auditor raised the issue of MCB adding an accounting control to prevent the issuance of duplicate invoices in the future. In fact, MCB had already instituted a computer checking system, whereby each invoice is checked by property case number and expense code, and compared against any other invoice already issued for that property. This system effectively prevents any further duplication of invoices and payments. Upon review of this issue, MCB determined that all of the duplicate invoices found by the auditor were dated prior to this change.

Ineligible Pass-Through Expenses. The IG audit reported 33 invoice line items where expenses covering 19 properties were incorrectly invoiced to HUD as pass-through expenses. Draft IG Audit Report, p. 12, Appendix E. As noted by the auditor, MCB was apprised of this finding as the audit was ongoing, and immediately remedied the problem by reimbursement to HUD by checks totaling \$11,433.17, dated June 27, 2000. See check copies, enclosed as Exhibit C.

Since that time, MCB has undertaken to implement additional management and accounting controls necessary to prevent the recurrence of such errors. As outlined in Exhibit D, the MCB invoicing procedures have been revised to ensure the application of a step-by-step process by which each HUD property file is assessed for completeness prior to the preparation of invoices relevant to the property. The file review is designed to ensure the consistent, proper analysis of the factors bearing on whether expenses incurred for that property are eligible under the contract to be paid by HUD as pass-through expenses. Routine application of this new step-by-step analysis will adequately screen out ineligible expenses prior to the preparation of an invoice. In addition, MCB has implemented a new procedure whereby MCB accounting personnel separately recheck all pass-through invoices to ensure that the eligibility checklist described above was applied properly in each instance. These new procedures should effectively eliminate most, if not all, expense eligibility issues associated with the proper payment of pass-through invoices under this, and any other, HUD contract.

Unsupported Costs. The IG auditor questioned the payment of an estimated \$104,238 in expenses for the repair and maintenance of properties covered by the HUD contract. Draft IG Audit Report, page 11. The draft report correctly noted that MCB "utilized a network of third party subcontractors" for the performance of repair work under this contract, whose invoices were then submitted by MCB to HUD for reimbursement as an eligible "pass-through" expense. However, the auditor questioned the reasonableness of expenses invoiced for repairs when the MCB subcontractor had, in turn, hired second-tier subcontractors to perform any portion of the work.

As explained by MCB at the time of the audit, this is a standard commercial practice in the industry. The hiring of subcontractors for repair work eligible as a pass-through expense, or otherwise mandated by the contract, was contemplated by the parties when MCB and HUD executed this contract. Moreover, the contract-imposed deadlines demand that much of this work be accelerated by the hiring of second-tier subcontractors for the repairs to be completed on time, pursuant to contract standards, and at a reasonable price. The cost of hiring and overseeing these necessary second-tier subcontractors is often reflected in the subcontractor's invoice paid by MCB for the work, the expense is reasonable and it is contemplated by all parties to the contract.

Pursuant to the draft audit report, this issue was referred to HUD contracting officials, who have indicated this practice to be reasonable under the contract terms. MCB received a copy of the correspondence confirming this determination by the cognizant HUD contracting officer, Ms. Jane Atkinson, whose determination stated that these expenses are reasonable and supported. See Contracting Officer's email correspondence, attached as Exhibit E. Thus, the entire \$104,238 questioned in the draft audit report

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should be deemed proper and reasonable, and a statement to that effect should be reflected in the revisions made to the final audit report.

IG Property Inspections. The Draft IG Audit Report also noted several deficiencies in the recordkeeping related to contract performance, and in some instances, questioned the performance of specific tasks required under the contract. For example, the auditor noted that, in 10 instances, the MCB initial inspections were performed later than the contract-required deadline, and 11 of the property appraisals in the auditor's sample were not performed within the required 10-day timeframe. Draft IG Audit Report, p. 5. In addition, certain of the properties inspected by the IG auditors revealed what were deemed to be "inspection deficiencies" inasmuch as they found properties with evidence of vandalism and other specific repairs that obviously needed attention. Draft IG Audit Report, pp. 5-7. From these findings, the auditor concluded that MCB's inspections were deficient and/or the subcontractors hired to perform repairs were given inadequate supervision or oversight.

Upon investigation into the specific properties noted by the IG, MCB disagreed in some instances with the auditor's interpretation of the contract repair requirements. For example, with respect to some properties, the IG claimed that evidence of a roof leak had not been remedied in terms of interior property repairs to the paint and plaster. Draft IG Audit Report, p. 28. In fact, under the terms of the contract, MCB is required to remedy the roof leak only if one exists while the property is held in MCB's inventory. In instances where the damage to interior walls and ceiling was the result of an earlier repaired roof leak, there is no requirement for such interior damage to appear on the MCB inspection report, nor are such repairs necessary before property sale.

In other instances cited by the IG audit, MCB agreed that the repair issues noted had merit, but did not constitute a performance deficiency. For example, MCB records confirm that certain of the defective paint findings were valid at the time of the IG inspection. Draft IG Audit Report, p. 27. However, defective paint remediation is generally not performed until just prior to the property closing, and is not required by the contract terms to be remedied before listing. Thus, as long as MCB properly addressed this issue prior to the property transferring to the new buyer, MCB's contract performance is not deficient.

The IG inspector also noted on Appendix B several deficiencies stemming from the lack of an "FHA Sign." Draft IG Audit Report, p. 21. In fact, MCB's records reflect that these properties all displayed an MCB sign at the time of the IG inspection, as required by the terms of the contract. Possibly, the IG inspector was not told that under the current contracts, the M&M contractor signage is the only required sign to be displayed. MCB contends that properties found with "No FHA Sign" should therefore, not constitute a performance deficiency.

Finally, the IG report cited evidence of vandalism in properties where the MCB records reflect that the property at issue was vandalized – and the resulting damage remedied by MCB – up to four, five, or six times prior to the sale of the property. Unfortunately, this is not uncommon. When a HUD property is located in a high crime location, even with a perfect record of inspection, appraisal and repair by MCB, the repairs necessitated by repeated acts of vandalism will reappear even if earlier vandalism damage had been remedied only days earlier.

However, since the time of the audit, MCB has instituted new procedures whereby additional property inspections and a systemized method of subcontractor oversight should resolve the outstanding issues raised concerning the adequacy or timeliness of inspections and appraisals, and the completeness of property repairs. First, after a careful review of the MCB property files relevant to these findings, MCB

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was able to determine which specific inspectors and appraisers were responsible for the late performance of these services. In a number of instances, the documentation was in fact supplied to a property file late, but the inspection and appraisal at issue had been performed on time. In other instances the inspection or appraisal had, in fact, been performed after the deadline. MCB has taken affirmative steps to prevent the late performance of these services, or even the untimely filing of the resulting paperwork, and has terminated the services of inspectors and appraisers whose performance history over the past 12 months revealed an inability to meet the contract deadlines.

Second, MCB has reassessed its practice of subcontracting out the function of subcontractor oversight and will send its own MCB employee inspectors out to oversee and verify the adequacy of all projects undertaken by subcontractors. This will increase the number of inspections performed on each and every property in the MCB inventory, as well as adequately monitor the performance of subcontractors prior to the property sale or preparation of invoices resulting from their work.

Third, MCB has further systematized the process of ordering inspections and appraisals on new properties in its inventory to prevent the untimely performance of these tasks. Under its enhanced system, an order for an inspection and appraisal is made when the property enters MCB's system. And, after the inspection and appraisal are ordered, the orders are automatically queued to be rechecked by MCB personnel to ensure both the timely performance of the inspection and appraisal, as well as the proper documentation thereof in the property file. See Exhibit F. This process should serve to prevent the untimely performance of these services in the future, help to avoid the confusion resulting from the improper documentation of such inspections/appraisals, as well serve as a monitor of the adequacy of the inspectors and appraisers hired for this service.

Conclusion. By this response, MCB believes it has addressed either the accuracy or cause of each and every one of the findings contained in the Draft IG Audit Report. Where necessary, MCB has implemented systematic changes to its standard operating procedures, specifically intended to ensure the highest level of consistent and timely performance of services under the contract. In addition, the MCB accounting controls in place have been amended to add the checks and rechecks necessary to avoid any of the prior invoicing errors. Finally, all monies due to HUD resulting from the invoice errors of MCB, as well as those found to be HUD's error, have been repaid in full. With these management changes in place, MCB looks forward to an even more efficient and consistent level of performance of its already successful HUD M&M contracts in the future.

Please note that all of the attached Exhibits are marked as containing protected material that is procurement sensitive as it contains confidential cost and pricing data, as well as information concerning the contractor's internal operating procedures. As such, none of the material in these Exhibits may be publicly released or otherwise disclosed to anyone other than the HUD Contracting Officer, or personnel within the HUD Office of Inspector General without the express written permission of the contractor.

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If there is additional information you require regarding any of the above responses, or you need additional information to assess MCB's action or position on these issues, please do not hesitate to contact me.

Sincerely,



Margaret Dillenburger Rifka
Counsel to
Michaelson, Connor & Boul

Enclosures 6

cc: Joan Heid
President
Michaelson, Connor & Boul

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Representatives, 2204 Rayburn Building, Washington, DC 20515

Ms. Cindy Fogleman, Subcommittee on Oversight and Investigations, Room 212, O'Neil House
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