
AUDIT REPORT



ASHLEY CROSSINGS APARTMENT HOMES

HUD PROJECT NO. 067-35331

2002-AT-1004

SEPTEMBER 26, 2002

OFFICE OF AUDIT, REGION 4



Issue Date	September 26, 2002
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TO: Donzella B. Hamm, Director, Atlanta Enforcement Center, VS4

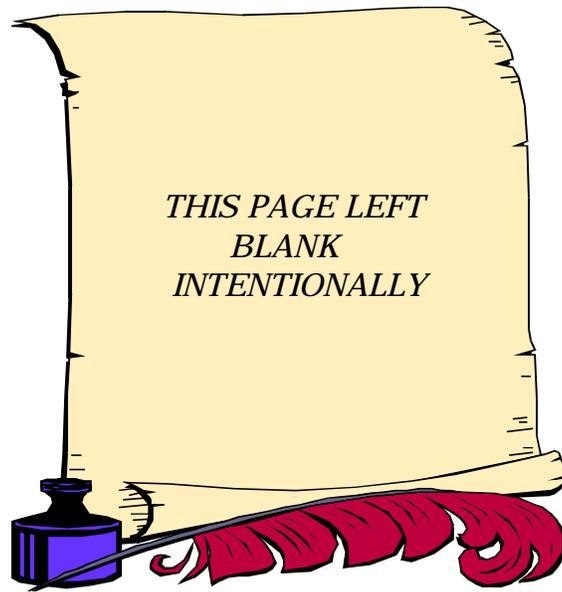
FROM: Nancy H. Cooper 
Regional Inspector General For Audit, Region 4, 4AGA

SUBJECT: Ashley Crossings Apartment Homes
HUD Project No. 067-35331
Largo, Florida

We audited the operations of Ashley Crossings Apartment Homes. The HUD Jacksonville Multifamily HUB office requested the audit because (1) the owner defaulted before final endorsement by the Department of Housing and Urban Development (HUD), (2) numerous liens were placed against the property, (3) the owner was not utilizing a HUD-approved management agent, and (4) there were concerns about information reported on the Monthly Accounting Reports. Our report contains three findings related to mismanagement of project operating funds, misuse of tenant security deposit funds, and the lack of full disclosure/diversion of mortgagor entity assets on the part of the project owner.

We have accepted your proposed management decisions for each report recommendation. Please advise us when all final actions have been completed. Also, please furnish us copies of any correspondence or directives issued because of the audit.

If you have any questions, please contact James D. McKay, Assistant Regional Inspector General for Audit, at (404) 331-3369.



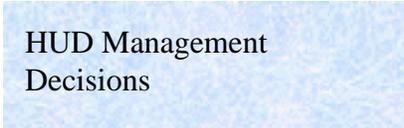
Executive Summary

We conducted the audit of Ashley Crossings Apartment Homes in response to a request by HUD, Jacksonville Multifamily HUB. HUD requested the audit because: (1) the owner defaulted before final endorsement, (2) numerous liens were placed against the property, (3) the owner was not utilizing a HUD-approved management agent, and (4) there were concerns about information reported on the Monthly Accounting Reports. We reviewed project operations, construction activities, and procedures relating to the application, Firm Commitment, and Initial Closing on the project. Specifically, the audit objectives were to determine (1) what transpired up to and during the initial closing, (2) if the owner used project operating and trust funds in compliance with the Regulatory Agreement and HUD requirements specifically related to the distributions of earnings, and (3) whether improper construction activities occurred during the project's rehabilitation period. We found no irregularities related to the construction activities.

The owner improperly disbursed \$312,439 in project operating and trust funds, while defaulting under the Regulatory Agreement and while providing HUD with inaccurate and incomplete information on monthly accounting reports. The ineligible disbursements consisted of \$200,330 for unauthorized distributions, including \$25,000 disbursed after the mortgage default, and \$112,109 for ineligible management agent expenditures. The misuse of funds contributed to the mortgage default and HUD's recommendation to foreclose on the mortgage.

The owner improperly used \$12,039 of tenant security deposits. As a result, project liabilities to tenants were not funded in a trust account as prescribed by HUD regulations. The owner also deposited tenant security deposits into the operating account initially and paid security deposit refunds from the operating account recently.

The owner failed to fully disclose all facts concerning the Ashley Crossings Project and mortgagor entity, and diverted mortgagor entity assets that could have been used for the project. HUD processed the loan application and approved the loan without full knowledge of all the relevant facts surrounding the acquisition of the property. Had HUD been aware of all the facts, the loan may not have been approved. As a result, the \$12,989,900 HUD insured loan went into default, was assigned to HUD, and was recommended for foreclosure. Subsequent to the foreclosure recommendation, HUD decided to dispose of the mortgage in a note sale. The FHA Insurance Fund stands to suffer a substantial loss when the mortgage note is sold as a result of the assignment.



HUD Management Decisions

We attributed the conditions to the owner's failure to follow HUD requirements.

We discussed the violations with the owner during the audit and we scheduled an exit conference for August 28, 2002. However, the owner requested a postponement and declined to reschedule an exit conference during subsequent contacts with him. Furthermore, the owner did not provide written comments even after we gave him

additional time to respond prior to preparing the final report.

We also discussed the draft findings with the Jacksonville Multifamily HUB office and the Atlanta Enforcement Center. In response to the draft findings, the Atlanta Enforcement Center agreed to be responsible for implementing the draft report recommendations. The Atlanta Enforcement Center agreed to require repayment of ineligible distributions and ineligible management agent expenditures. The Center also agreed to pursue debarment action against the mortgagor entity and its individual principals.

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Introduction

Ashley Crossings Apartment Homes, located in Largo, Florida, is a 278-unit profit motivated project owned by Ashley Crossings Apartment Homes of Florida, LP (Mortgagor). HUD authorized and financed the project under Section 221(d)(4) Substantial Rehabilitation. The partners in the mortgagor entity are Mason-Phillips Properties of Florida IV, Inc. (Managing General Partner) and Tampa Club, Inc. (General Partner). Charles E. Hartman and Vanessa L. Hartman were listed as President and Vice President of Mason-Phillips Properties, respectively. The Hartmans are father and daughter, who subsequently switched roles in the company. Stuart Chalfin was President of Tampa Club. Charles Hartman (herein referred to as “owner” or “mortgagor”) had primary responsibility for the project and maintenance of its books and records.

On June 17, 1999, HUD issued a Commitment for Insurance of Advances (Firm Commitment). The mortgagee, Continental Wingate Associates, Inc., requested that HUD reissue the Firm Commitment due to a change in the interest rate. HUD reissued the Firm Commitment on July 21, 1999. The maximum FHA Insured Loan amount was \$12,989,900. The Initial Endorsement and Initial Closing occurred on August 25, 1999. However, the Regulatory Agreement and the Mortgage were signed and dated on August 24, 1999.

Construction began in September 1999. During the construction period the owner failed to pay the contractor, real estate taxes, and water and sewer charges. The Douglas Company, general contractor, stopped work on May 23, 2000, because the owner had not paid for work completed to that point. Three months later, the owner and contractor reached an agreement and work recommenced on August 24, 2000. On December 14, 2000, HUD certified that the contractor’s work was 100 percent complete. However, the project was only 96 percent complete as a result of the City of Largo citing local building code deficiencies. The work necessary to correct those deficiencies was the owner’s responsibility and was outside the contractor’s scope of work. The project could not be finally inspected until the owner completed his portion of the work, so that the Certificate of Compliance could be issued.

The owner did not make the mortgage payments due on January 1, and February 1, 2001, and allowed the mortgage to go into default. HUD provided the owner an opportunity to correct all violations of the mortgage and Regulatory Agreement. The owner objected to all violations cited by HUD. The project never reached Final Endorsement, as the owner never submitted a Cost Certification. The mortgagee assigned the loan to HUD on May 10, 2001. The Jacksonville Multifamily HUB recommended debarment of Ashley Crossings ownership entities, and on May 17, 2001, recommended foreclosure.

While our audit was in progress, HUD decided to dispose of the property via a Note Sale. The process was still underway when we completed our audit work.

Audit Objectives

The audit objectives were to determine (1) what transpired up to and during the initial closing, (2) if the owner used project operating and trust funds in compliance with the Regulatory Agreement and HUD requirements specifically related to the distributions of earnings, and (3) whether improper construction activities occurred during the project's rehabilitation period.

To accomplish the objective, we reviewed project records at HUD's office in Jacksonville, Florida; the office of the owner/manager of Ashley Crossings Apartment Homes in Ponte Vedra Beach, Florida; and the project's leasing office in Largo, Florida. We also interviewed officials at HUD's Jacksonville and Atlanta offices, the owner/manager, the on-site property manager, the owner's accountant, and mortgagee officials. We tested project accounting records and interviewed the owner and his accountant to gain an understanding of the management controls relevant to the audit.

Audit Scope and Methodology

The main focus of the audit covered the period May 1997 through March 2002, although the initial application was submitted to HUD in late 1996. Between 1999 and February 2002 the project generated revenue of \$588,209 and disbursed \$586,845 from its operating account. We reviewed 100 percent of the income and disbursement transactions for the operating account during that period. We also reviewed all disbursements from the Tenant Security Deposit Account totaling \$12,837. We conducted the audit from February through June 2002 in accordance with generally accepted government auditing standards.

Mismanagement of Project Funds

Ashley Crossing's managing owner improperly disbursed \$312,439 in project operating and trust funds, while defaulting under the Regulatory Agreement and while providing HUD with inaccurate and incomplete information on monthly accounting reports. The ineligible disbursements consisted of \$200,330 for unauthorized distributions, including \$25,000 disbursed after the mortgage default, and \$112,109 for ineligible management agent expenditures. The misuse of funds contributed to the mortgage default and HUD's recommendation to foreclose on the mortgage. We attribute these conditions to the owner's failure to abide by HUD requirements.

HUD requires monthly accounting reports.

According to the Regulatory Agreement, Section 9(f), at HUD's request, the owner shall furnish monthly occupancy reports and shall give specific answers to questions upon which information is desired from time to time relative to income, assets, liabilities, contracts, operations, conditions of the property, and the status of the insured mortgage. HUD Handbook 4370.1, Reviewing Annual and Monthly Financial Reports, provides that monthly accounting reports are useful tools for evaluating a project's performance and monitoring compliance. The reports are generally required when there are indications that the project is experiencing financial or management difficulties or the owner/agent is suspected of noncompliance. Possible actions that may be needed after reviewing monthly accounting reports that depict errors, incomplete forms, noncompliance, and questionable disbursements include written communication with the owner or enforcement action, if appropriate. HUD required the owner to use the form "Monthly Report for Establishing Net Income" to prepare monthly accounting reports. The form provided for detailed reporting of project cash balances, disbursements, and accounts payable.

Owner provided inaccurate and incomplete monthly accounting reports to HUD

The owner repeatedly submitted incomplete, inaccurate, and improperly prepared monthly accounting reports. The owner began submitting monthly accounting reports in September 2000. According to the mortgagee and HUD, the reports (1) lacked supporting documentation, (2) omitted disbursements and payables, and (3) included computation errors and questionable disbursements. The mortgagee and HUD posed questions and expressed concerns in writing to the owner regarding monthly reports

from October 2000 through December 2001. The owner's monthly reports for January and February 2002 were delinquent. In responses to the mortgagee and HUD, the owner's executive assistant admitted ignorance of how to prepare parts of the monthly reports, but did not respond to all issues. For example, there were no responses to requests for return of funds paid to an unacceptable management agent or explanations of \$4,500 and \$1,800 disbursements for miscellaneous administrative expenses. We also questioned the owner concerning information on the monthly accounting reports. The owner claimed that the inconsistencies in the monthly accounting reports were due to incompetent employees, poor record keeping, and poor reporting. The owner is ultimately responsible for information submitted to HUD, therefore we attribute the condition to the owner's failure to abide by HUD requirements. Appendix D provides more detailed descriptions of the discrepancies and concerns identified in Ashley Crossing's monthly reports by the mortgagee and HUD.

By continuously providing incomplete, inaccurate, and improperly prepared monthly accounting reports, the owner deprived HUD of accurate financial information needed to effectively monitor project revenues, disbursements, and obligations.

Between August 1999 and February 2002, the owner made 520 disbursements totaling \$586,845 from the project operating account. The owner also made two withdrawals totaling \$12,039 from the tenant security deposit account. We reviewed all disbursements and both withdrawals. The disbursements consisted of 134 payments totaling \$200,330 for ineligible distributions to the owner, his partners, investors, or his related company, and 51 payments totaling \$112,109 for ineligible management agent expenditures. The total ineligible expenditures of \$312,439 amounted to over 52 percent of project expenditures.

HUD limits distributions only from surplus cash.

The Regulatory Agreement, Section 13(g), defines a distribution as any withdrawal or taking of project cash or any assets of the project including the segregation of cash for subsequent withdrawal, excluding payments for reasonable expenses incidental to the operations and maintenance of the project. Section 6(b), states that, without HUD's prior written permission, owners shall not make or receive and retain any distribution of assets or any income of any kind of the project except surplus cash. Owners shall not without the prior written approval of the Secretary: assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs. The Regulatory Agreement further states that, (1) owners shall not make distributions from borrowed funds, prior to completion of the project, or when there is any default under the Regulatory Agreement or under the note or mortgage (Section 6(e)) and (2) any owner receiving such funds in violation of the Regulatory Agreement shall hold such funds in trust (Section 9(g)). HUD Handbook 4370.2, Financial Operations and Accounting Procedures, paragraph 2-10F, states that distributions may be made only if owners have been in compliance with all provisions of the Regulatory Agreement, including the requirement for the project to be in good repair and condition.

Ineligible distributions to owners.

The owner disbursed \$200,330 from project operating and trust funds for unauthorized distributions, including \$148,300 that directly benefited the owner in payments to himself and his management company. The \$148,300 included \$2,000 improperly disbursed from the tenant security deposit trust account. The owner also disbursed the remaining \$52,030 of unauthorized distributions to the general and limited partners and investors. We consider the disbursements to be unauthorized distributions because the disbursements were made when the project was in violation of the Regulatory Agreement and when the physical condition needed to be brought up to code. The City of Largo had cited the project for local building code deficiencies.

The owner failed to abide by HUD requirements and improperly used project operating and trust funds to make the unauthorized distributions. The project generated sufficient cash to make some mortgage payments. The unauthorized distributions from the operating account could have funded two \$86,685 mortgage payments. The owner’s misuse of project funds and failure to make mortgage payments contributed to the mortgage default, subsequent mortgage assignment to HUD, and HUD’s foreclosure recommendation. Appendix C, Part I provides a detailed listing of the ineligible distributions summarized below:

Payee	Amount
Charles Hartman	\$ 500
Mason-Phillips Management Company	147,800
Tampa Club Partners, Inc.	8,250
Universal Corporation of Pinellas County	8,000
Investors	35,780
<hr/>	
Total Ineligible Distributions	\$ 200,330

The above distributions violated the project Regulatory Agreement and are subject to the double damages remedy for unauthorized use of multifamily housing project assets and income (12 USC 1715z-4a). Furthermore, the owner paid \$25,000 to himself or his management company after mortgage default, which is subject to remedy under the equity skimming statute (12 USC 1715z-19).

Ineligible management agent expenditures

The Regulatory Agreement, Section 6(c) states that owners shall not without the prior written approval of the Secretary, convey, assign, or transfer any right to manage or receive the rents and profits from the mortgaged property. Section 6(e)(3), also states that any distribution of any funds of the project, which the party receiving such funds is not entitled to retain, shall be held in trust separate and apart from any other funds.

Ashley Crossings owner disbursed \$112,109 in project operating funds to property management agents not approved by HUD. Those property management agents were Mountain Heritage and its affiliates - Ward’s Painting and Lisa Kessler, which the owner allowed to collect rents.

HUD did not approve Mountain Heritage as property management agent and had advised the project owner on several occasions that Mountain Heritage was not an acceptable property management agent. The owner disregarded HUD's instructions and continued to use Mountain Heritage and its affiliated companies as on site property managers. Therefore, all disbursements to Mountain Heritage, Ward's Painting, and Lisa Kessler are ineligible. Appendix C, Part II provides a detailed listing of the ineligible management agent expenditures summarized below:

Description	Amount
Payroll, Maintenance, and Repairs	\$ 71,673
Supplies and Services	25,473
Employee Benefits and Profit	14,942
Overpayment of Payroll Expense	21
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Total Ineligible Management Agent Expenditures	\$ 112,109

The owner's lack of effort to make any mortgage payments and mismanagement of project funds were significant causes of the mortgage default. Accordingly, HUD's Jacksonville office recommended debarment action against the project owners based on several violations of the Regulatory Agreement and the mortgage, including failure to make mortgage payments, unauthorized payments to the owner, and unauthorized payments to a non-approved management company.

Auditee Comments

The owner did not respond to the finding.

HUD Management Decision

The Atlanta Enforcement Center agreed to take the following actions:

- 1A. Require the owner to reimburse the project operating and trust accounts in the amount of \$200,330 for ineligible distributions and \$112,109 for ineligible management agent expenditures.

- 1B. Pursue appropriate sanctions available under the Regulatory Agreement, Equity Skimming Statute, and the Double Damage Statutes against the mortgagor entity and its individual principals.

- 1C. Debar the mortgagor entity and its individual principals from future participation in HUD Programs based upon a history of unsatisfactory performance of regulatory requirements.

Misuse of Tenant Security Deposits

The owner improperly used \$12,039 of tenant security deposits. As a result, project liabilities to tenants were not funded in a trust account as prescribed by HUD regulations. The owner also deposited tenant security deposits into the operating account initially and paid security deposit refunds from the operating account recently. We attribute these violations to the owner's failure to abide by HUD requirements.

The Regulatory Agreement, Section 6(g), states that any funds collected as security deposits shall be kept separate and apart from all other funds in a trust account. The amount of the trust account shall at all times equal or exceed the aggregate of all outstanding obligations under said account.

The owner deposited the first \$600 of security deposit collections into the project operating account. The collection appeared to have been subsequently deposited to the tenant security deposit account when it was opened. Recently, the owner paid \$247 from the operating account to tenants for security deposit refunds because he had not ordered checks for the security deposit account.

Initially, we determined that, as of February 28, 2002, the cash balance in the tenant security deposit trust account was \$10,546 which was \$1,202 less than the \$11,748 liability for security deposits that we calculated. We used information from the Rent Roll system, monthly accounting reports, and bank statements to calculate the liability. We attributed most of the shortage to an improper \$2,000 withdrawal from the account in March 2001, which was used to pay marketing expenses for the owner's management company. The owner stated that the amount was withdrawn in error and the account was later reimbursed. We found no evidence that the \$2,000 was ever fully reimbursed.

We obtained a bank statement for the month following the cutoff date of the above analysis and found that the account was cleared out and had a zero balance as of March 29, 2002. The statement showed a \$300 deposit on March 5, 2002, a service charge deduction of \$8.72, and a withdrawal of \$10,837 described as a writ received from Dart Electronics, Inc. on March 12, 2002. The owner stated that the funds were attached in response to a lawsuit against him. He further stated that the money was not taken, but placed in suspense pending settlement of the lawsuit. The owner claimed that he had already settled the suit with the plaintiff and the funds would soon be released. However, at the time of our conversation, the funds had not yet been returned to the account. Therefore, considering Rent Roll and monthly accounting data, the account was under funded by \$12,039 (\$11,748 plus \$300 minus \$8.72) as of March 29, 2002. The balance in the trust account should equal or exceed the aggregate of all outstanding obligations reflected by the security deposit liability account. As of March 29, 2002, the trust account for security deposits contained a zero (\$0) balance.

Finding 2

In summary, the owner stated that he spent the security deposit account funds in March 2001 in error and in March 2002 the funds were garnished due to a lawsuit. We had no evidence that the account was replenished at either time. Therefore, we conclude that the owner mismanaged the tenant security deposit funds.

Auditee Comments

The owner did not respond to the finding.

HUD management decision

The Atlanta Enforcement Center agreed to:

- 2A. Require the owner to reimburse the tenant security deposit trust account in the amount of \$12,039 for improper disbursements, unless he can provide evidence the tenant security deposit account was replenished.

Owner Did Not Fully Disclose Facts to HUD and Diverted Mortgagor Entity Assets

The owner failed to fully disclose all facts concerning the Ashley Crossings Project and mortgagor entity, and diverted mortgagor entity assets that could have been used for the project. HUD processed the loan application and approved the loan without full knowledge of all the relevant facts surrounding the acquisition of the property. Had HUD been aware of all the facts, the loan may not have been approved. As a result, the \$12,989,900 HUD insured loan went into default, was assigned to HUD, and was recommended for foreclosure. Subsequent to the foreclosure recommendation, HUD decided to dispose of the mortgage in a note sale. The FHA Insurance Fund stands to suffer a substantial loss when the mortgage note is sold as a result of the assignment.

HUD Handbook 4065.1, paragraph 1-2, states that it is HUD's policy that participants in its housing programs be responsible individuals and organizations who will honor their legal, financial, fair housing, and contractual obligations. It further states that "responsibility" is a term used by HUD to mean business integrity, honesty and capacity to perform. HUD has a process for review of past/present performance of those principals applying for participation in the Department's Multifamily Housing programs, which is known as a Previous Participation Review and Clearance Procedures or Form HUD 2530 Previous Participation Certification approval. The handbook also defines who is considered to be principals of a project. HUD Handbook 4370.2, paragraph 2.3, states that both the Regulatory Agreement and the certificate executed by the mortgagor, at the time the mortgage is insured, contain provisions that accounts of mortgaged property operations be kept in accordance with the requirements of the Secretary and in such form as to permit a speedy and effective audit. HUD Handbook 4470.1, paragraph 3.1, states that the sponsor, mortgagor (if formed), principals of the mortgagor, and general contractor must furnish current financial statements with supporting schedules as part of the application for commitment processing.

HUD's debarment regulations at Title 24 CFR 24.305 (d) provides that debarment may be imposed for any cause of so serious or compelling a nature that it affects the present responsibility of a person.

Owner failed to fully disclose facts to HUD

Throughout the loan application, underwriting, and Firm Commitment processes, the owner failed to make full disclosure of all facts. Changes occurred between the time of Firm Commitment and Initial Closing that should have been brought to the attention of HUD. Because the owner failed to disclose all relevant information, HUD was deprived of information that could have affected its decision to issue the Firm Commitment and proceed with

the Initial Closing on the loan. The owner's pattern of less than full disclosure continues up to the present time with his failure to provide all requested documentation to the Jacksonville Multi-Family staff and to the OIG auditors conducting this audit.

Charles E. Hartman considered as "owner" and controlling participant

The key individual controlling the Ashley Crossings project was Charles E. Hartman. Per the initial loan applications, Mr. Hartman was to have been a principal of Ashley Crossings and was to have been the President of the Managing General Partner entity (Mason-Phillips Properties of Florida, IV, Inc.). However, due to an existing Internal Revenue Service tax lien and lack of financial capacity, Mr. Hartman was not used as a principal. Several other individuals, who had financial capacity and creditworthiness, were subsequently used as sponsors to satisfy HUD loan underwriting requirements. Mr. Hartman's daughter, Vanessa L. Hartman, was subsequently named President of the Managing General Partner entity. Charles Hartman was named as Vice-President. Our audit disclosed that Charles Hartman signed Vanessa Hartman's name to several key documents (including the Application for Multifamily Housing Project, HUD Form 92013) provided to HUD without proper Power of Attorney to do so. Technically, that constitutes forgery on the part of Charles Hartman.

Charles Hartman has stated that Vanessa Hartman was not involved at all in the day-to-day operations of Ashley Crossings. Thus, it was Charles Hartman who was responsible for the representations made to HUD and he is responsible for what happened concerning Ashley Crossings. Therefore, we consider Charles Hartman to be the "owner" of Ashley Crossings, although he was technically not a "principal" as defined by HUD guidance. As the owner and controlling participant in Ashley Crossings concerning the housing program, HUD would expect him to demonstrate the same level of "responsibility" as any principal. It is clear he did not exercise this responsibility and did not honor his legal, financial, and contractual obligations. This resulted in the default and assignment of the HUD Insured loan.

Misrepresentations concerning the Mortgagor Entity and its Financial Structure

The mortgagor entity was presented to HUD, per the application, as a newly formed entity without any financial or credit history. This turns out to be only partially true. It is true that the mortgagor (Ashley Crossings Apartment Homes of Florida, Limited Partnership) had only been formed four months prior to the filing of an amended loan application on July 30, 1998. However, the owner had obtained loans during 1997 and early 1998 from individuals and solicited funds from investors in Ashley Crossings. These loans and investments were obtained for the specific purpose of the Ashley Crossings project. Part of these investments was considered by the owner to be "Notes Payable" rather than owner equity. The owner had already begun to pay the investors monthly "interest" on their investments or notes payable. Thus the owner had effectively established liabilities for the mortgagor entity that were not disclosed to HUD. Although we found no proof that any of these loans or "notes payable" were directly attached to the project property, they did represent financial obligations of the mortgagor entity that should have been disclosed to HUD.

Identity of Interest Relationship between Mortgagor Entity and the Seller

Per the loan application, the relationship between the Buyer (mortgagor entity) and the Seller (Universal Corporation) was stated to be a "business" relationship. That might have been the case at the time the application was initially filed with HUD. However, sometime prior to the Initial Closing the Seller became a "limited partner" in the mortgagor entity and had agreed to put up \$1.87 million of its equity in the property in order for the transaction to close. While the Seller's 10 percent limited partner interest in the mortgagor entity did not technically trigger the requirement for Form 2530 filing (due to not meeting the definition of a principal with at least 25 percent interest), the contribution of \$1.87 million in equity was a substantial change in the financial underwriting of the project. It was materially different than that presented during the application and Firm Commitment process. This resulted in a situation where, instead of the Sponsors (who had shown "financial

capacity" to support the cash requirements of the project) having to put up the cash, the Seller used a substantial part of its equity in the property to satisfy the cash requirement. This may not technically meet the "substantial deviation" test, but it certainly was a material change that should have been clearly brought to the attention of HUD prior to Initial Closing. We consider this to be a failure to disclose an identify of interest relationship between the Buyer and the Seller since this placed the Seller in a position of having more financial interest (equity) in Ashley Crossings than any other limited or general partner.

Amendments to the Partnership Agreement Not Timely Provided to HUD

Part of the documentation presented to HUD during the Initial Closing process was an Amended Partnership Agreement reflecting that the Seller of the property had become a limited partner in the partnership as discussed above. This documentation should have been presented to HUD at least 15 days prior to the Initial Closing as part of the pre-closing documentation package. The Amended Partnership Agreement was dated the same day as the Initial Closing. Merely providing a copy of an Amended Partnership Agreement as part of a large package of documents during the Initial Closing process was not adequate and clear disclosure of this material change. This is just another example of how the owner failed to provide HUD with information, or failed to provide it in a timely manner that would have allowed adequate time for HUD staff to review it and assess its impact on their decision to approve and process the loan.

Owner's Failure to Maintain Adequate Accounting System and Provide Annual Financial Statements

The owner has not maintained an adequate accounting system and has not filed the Final Cost Certifications and subsequent Annual Financial Statements as required by the Regulatory Agreement and other HUD handbooks. During the audit, we found the accounting system used by Ashley Crossings to be little more than a data entry system. The owner did not maintain adequate records of project transactions or investor contributions. For example, expenses were not posted to the proper accounts and many

items such as bank service charges, deposits, and returned checks were not recorded in the cash register or posted to the general ledger.

Additionally, we found that the owner had solicited investments of \$2.54 million for use in the project. Only \$870,000 went into an escrow account. The owner claimed that all funds from investors were used to cover expenses of the project. However, he did not document those expenditures in Ashley Crossings accounting system. Even the owner and his accountant advised us that the project accounting system was not adequately maintained, and therefore, recorded data may not be accurate. This lack of an adequate accounting system and the lack of financial statements created additional work for us. Missing supporting documentation was also a problem during the audit. The lack of documentation and adequate records was given by one of the other General Partners (who was responsible for preparing financial statements and tax returns) as the reason for his inability to accomplish his designated responsibilities.

Owner diverted
mortgagor entity assets

During 1997 through 2000, the owner solicited numerous loans and investments from investors (Note Holders, Limited Partners, and General Partners) for the specific purpose of providing funds for Ashley Crossings. There were two private offerings made on behalf of Ashley Crossings whereby the owner attempted to raise a total of \$6.37 million. In total, the owner raised \$2.54 million from lenders and investors that was to be used for Ashley Crossings. Only about \$870,000 was deposited in an escrow account. Prior to the Initial Closing on August 25, 1999, almost all of these funds had been transferred from the escrow account to one of Mr. Hartman's other business accounts (Mason-Phillips Management Company, Inc.). We were not provided with documentation to show where the remaining \$1.67 million was deposited.

While the owner claims to have used these funds for purposes connected to Ashley Crossings, he failed to provide adequate documentation to support his claim. He only provided copies of a Mason-Phillips Management Company, Inc. general ledger account (Accounts Receivable from Ashley Crossings) for the payments he claims were made on behalf of Ashley Crossings, and

copies of cancelled checks. The general ledger account and cancelled checks are not adequate supporting documentation. They only show that payments were made, not that they were payments for legitimate expenses of Ashley Crossings. Even this unsupported information does not account for the full \$2.54 million collected on behalf of Ashley Crossings.

The \$2.54 million in funds collected by the owner on behalf of Ashley Crossings would have been sufficient to cover all known expenses connected with the development of the project that were not covered by the HUD insured loan of \$12,989,900 from Continental Wingate Associates. The owner could have used these funds to make mortgage interest and loan payments and prevented the loan from going into default status and subsequent assignment. It is apparent that a substantial amount of these funds were diverted by the owner and not used or made available for the Ashley Crossings Project. Given the amount of funds that were raised on behalf of Ashley Crossings and should have been available for the project, it is difficult to understand why this project failed and how the loan went into default and was assigned back to HUD. For example, at the end of the construction period (when rehabilitation had been completed by the General Contractor), there was only an estimated \$75,000 worth of additional work that needed to be completed to satisfy local building codes and obtain Certificates of Occupancy for all buildings in the project complex. With Certificates of Occupancy the project could have moved forward to full lease-up status and generated sufficient rental revenues to sustain the mortgage payments and operating expenses.

We believe the violations of the Regulatory Agreement discussed in Findings 1 and 2, along with the default and assignment of the Ashley Crossings HUD insured loan are sufficient grounds to take debarment actions against Charles E. Hartman. The facts presented in this finding add additional support for immediate action to prevent Mr. Hartman, or any entity under his control, from participating in any future HUD housing programs.

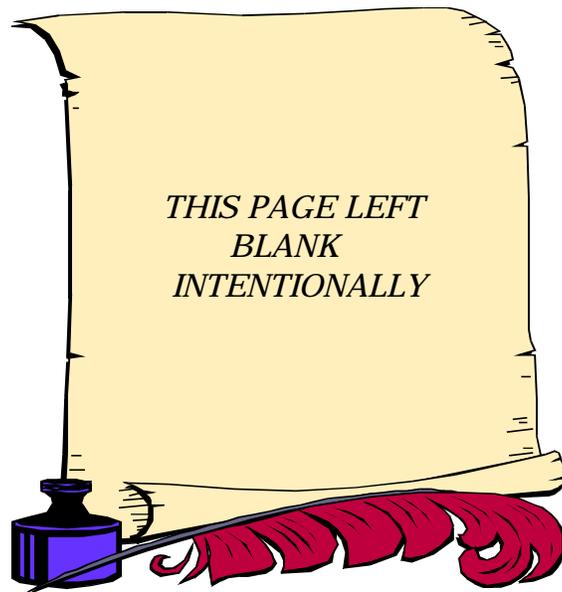
Auditee Comments

The owner did not respond to the finding.


HUD management
decision

The Atlanta Enforcement Center agreed to

- 3A. Take immediate action to debar the mortgagor entity and its individual principals from future participation in HUD Programs based upon a lack of present responsibility.



Management Controls

In planning and performing our audit, we considered management control systems of Ashley Crossings Apartment Homes to determine our auditing procedure and not to provide assurance on management controls. Management control includes the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.




Relevant Management Controls

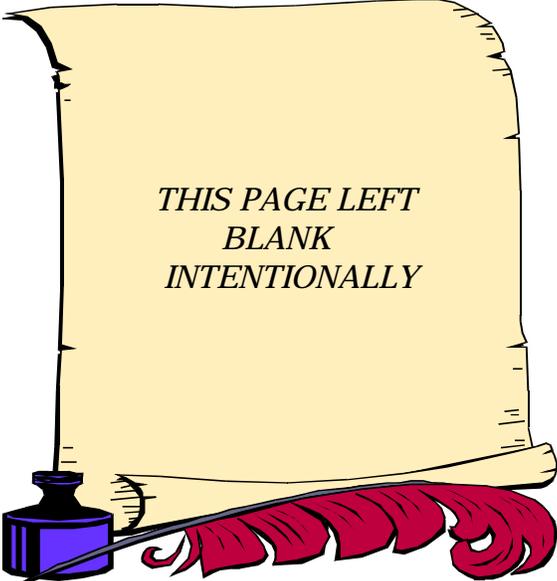
We determined the following management controls were relevant to our audit objectives:

- Controls over the validity and reliability of data
- Controls over compliance with laws and regulations
- Controls over the safeguarding of resources

We assessed the relevant controls identified above.

A significant weakness exists if management control does 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.

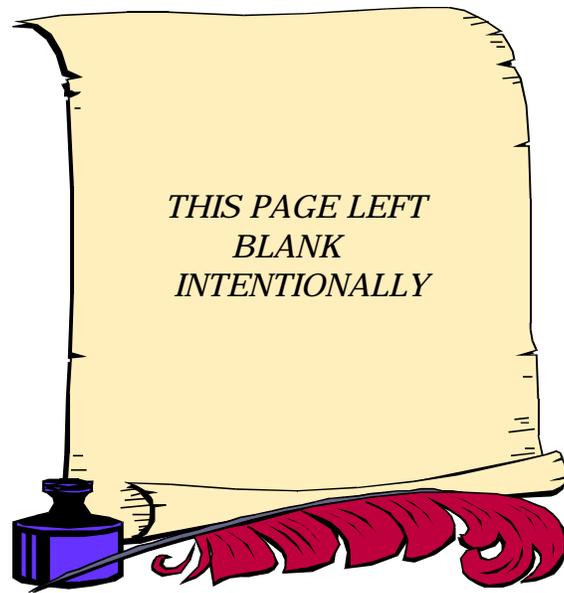
We tested project accounting records and interviewed the owner and his accountant to gain an understanding of the management controls relevant to the audit. Significant weaknesses in the assessed controls existed with respect to the owner controlling, managing, and reporting on the project without regard for HUD program requirements and prudent financial management. We placed no reliance on the controls and instead reviewed all project income and disbursements and tenant security account withdrawals. The control weaknesses were the primary causal factors for Findings 1, 2, and 3.



Follow-Up On Prior Audits

This was the first Office of Inspector General audit of Ashley Crossings Apartment Homes mortgagor operations.

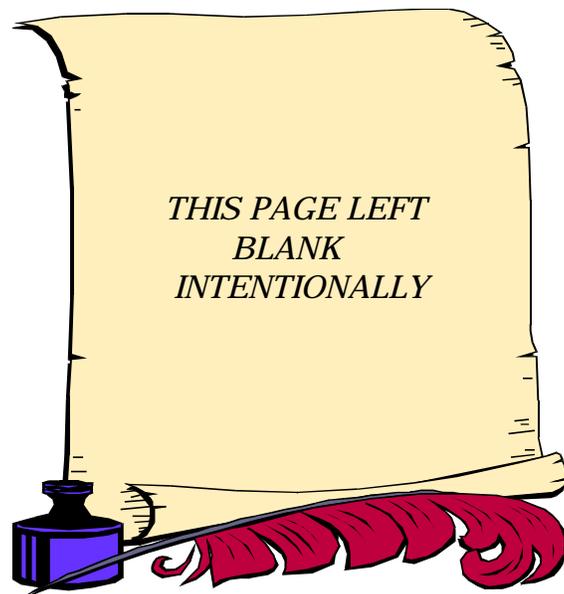
An independent audit of Ashley Crossings Apartment Homes has not been conducted since its inception.



Schedule of Ineligible Costs

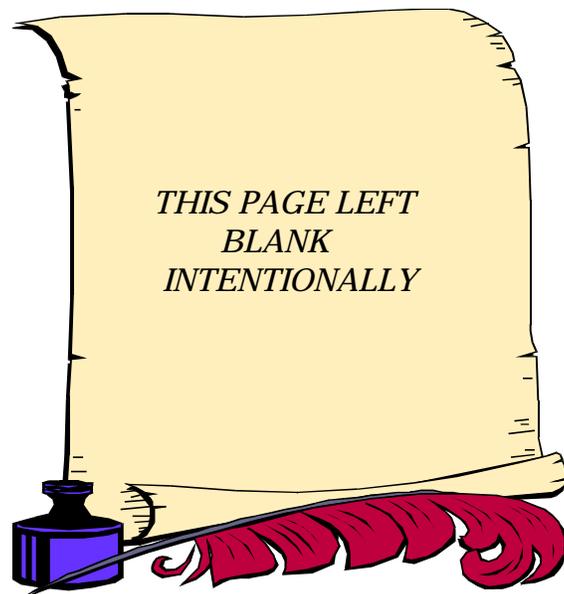
HUD Management Decision Number	Ineligible ^{1/}
1A	\$ 312,439
2A	<u>12,039</u>
Total	<u>\$ 324,478</u>

^{1/} Ineligible – Costs that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other document governing the expenditure.



Summary of Finding 1 Ineligible Expenditures

Payee	Amount
Charles Hartman	\$ 500
Mason-Phillips Management Company	147,800
Tampa Club Partners, Inc.	8,250
Universal Corporation of Pinellas County	8,000
Investors	35,780
Management Agents	112,109
<hr/> Total Ineligible Expenditures	<hr/> \$ 312,439



Detailed Schedule of Finding 1 Ineligible Expenditures

Part I

Ineligible Distributions

Date	Check No.	Payee	Ineligible Amount ^{1/}	Paid While in Default ^{2/}
08/31/99	1003	Mason-Phillips Management Co.	\$ 42,000.00	
09/16/99	1080	Mason-Phillips Management Co.	5,000.00	
09/29/99	1099	Mason-Phillips Management Co.	10,000.00	
10/08/99	1161	Mason-Phillips Management Co.	1,000.00	
11/02/99	1173	Mason-Phillips Management Co.	1,000.00	
01/24/00	2011	Mason-Phillips Management Co.	5,000.00	
02/24/00	2021	Mason-Phillips Management Co.	7,000.00	
05/17/00	2039	Mason-Phillips Management Co.	30,000.00	
05/23/00	2041	Mason-Phillips Management Co.	16,000.00	
12/01/00	2069	Mason-Phillips Management Co.	4,500.00	
01/01/01	2070	Mason-Phillips Management Co.	1,800.00	
02/01/01	2498	Mason-Phillips Management Co.	6,500.00	6,500.00
03/12/01	2492	Mason-Phillips Management Co.	4,000.00	4,000.00
03/30/01	2493	Mason-Phillips Management Co.	1,500.00	1,500.00
04/24/01	2391	Mason-Phillips Management Co.	7,500.00	7,500.00
08/16/01	2469	Mason-Phillips Management Co.	1,500.00	1,500.00
10/03/01	2098	Mason-Phillips Management Co.	1,500.00	1,500.00
02/23/01	2081	Charles Hartman	500.00	500.00
03/05/01	^{-3/}	Mason-Phillips Management Co.	2,000.00	2,000.00
Subtotal - Mason-Phillips Management Co. and Charles Hartman			\$ 148,300.00	\$ 25,000.00
08/31/99	1004	Universal Corp.	\$ 8,000.00	
Subtotal - Universal Corp.			\$ 8,000.00	
10/04/99	1107	Tampa Club Partners	\$ 4,125.00	
10/06/99	1157	Tampa Club Partners	\$ 4,125.00	
Subtotal - Tampa Club Partners			\$ 8,250.00	

^{1/} Ineligible – Costs that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other document governing the expenditure.

^{2/} These distributions were made while the mortgage was in default beginning February 1, 2002.

^{3/} Security Deposit Account

Appendix C

Date	Check No.	Payee	Ineligible Amount ^{1/}	Paid While in Default ^{2/}
09/13/99	1009	William Or Sharron Bair	\$ 500.00	
09/13/99	1010	Alan L Barton Retirement Acct., Inc.	220.00	
09/13/99	1011	Christina F. Behrens Retirement Acct., Inc.	125.00	
09/13/99	1012	Ted Berndt Retirement Acct., Inc.	250.00	
09/13/99	1013	Frederick & Lois Biederman	250.00	
09/13/99	1014	May Financial Corp for L. Jack Borsum	500.00	
09/13/99	1015	Marjorie Borsum Trust	250.00	
09/13/99	1016	S. Eileen Brezler	500.00	
09/13/99	1017	Henry Brumbach	250.00	
09/13/99	1018	Colin Burgess	750.00	
09/13/99	1019	Harold E. Burt Retirement Accts.	150.00	
09/13/99	1020	Thomas F Cullop Retirement Accts	500.00	
09/13/99	1021	Dweyer Family Trust	1,025.84	
09/13/99	1022	Anne L. Evans Retirement Accts	250.00	
09/13/99	1023	Bessie C. Fennell (Nations Bank by Mail)	263.75	
09/13/99	1024	Patricia Fleming	375.00	
09/13/99	1025	Martha C. Haner	300.00	
09/13/99	1026	Sharon E Harrell (Retirement Accts)	500.00	
09/13/99	1027	Herman and Jane Hasselbring	1,000.00	
09/13/99	1028	James F Hawkins	250.00	
09/13/99	1029	Sharon A Herring, (Retirement Accts)	500.00	
09/13/99	1030	Stanley or Rebekah Hime	250.00	
09/13/99	1031	William A Iles Trust	388.75	
09/13/99	1032	John Jacobsen	250.00	
09/13/99	1033	Harry and Marjorie Judy	150.00	
09/13/99	1034	H. Jack & Janet L. Judy Trust	300.00	
09/13/99	1035	Kolseth Revocable Trust	200.00	
09/13/99	1036	Catherine Kraus	250.00	
09/13/99	1037	Mary Kraus	185.00	
09/13/99	1038	Willadean Lamotte (Retirement Accts)	500.00	
09/13/99	1039	Barbara Leohwing	500.00	
09/13/99	1040	Leatrice Makrouer	255.50	
09/13/99	1041	Peter J. Merkle (Retirement Accts)	500.00	
09/13/99	1042	Charles V. Mullen, Sr	200.00	
09/13/99	1043	Charles C. Mullen, Jr	150.00	
09/13/99	1044	James Phoa	55.00	
09/13/99	1045	Phyllis Phoa	150.00	
09/13/99	1046	Katie Pike or Anita Kirkwood	150.00	
09/13/99	1047	Lynn Queenan (Retirement Accts)	130.00	
09/13/99	1048	Ralph and Marjorie Schockey	120.00	
09/13/99	1049	Ruth B. Setser Rev. Trust	300.00	

Date	Check No.	Payee	Ineligible Amount ^{1/}	Paid While in Default ^{2/}
09/13/99	1050	Frances R. Shepherd	277.50	
09/13/99	1051	John D Shirley (Retirement Accts,	372.84	
09/13/99	1052	Elliot S. Silverman	250.00	
09/13/99	1053	Jan Silverman	250.00	
09/13/99	1054	William or Jean Sponseller	300.00	
09/13/99	1055	David Watson	250.00	
09/13/99	1056	Maxine Weinberger	250.00	
09/16/99	1079	Laura Travis	16.00	
10/06/99	1109	William Or Sharron Bair	500.00	
10/06/99	1110	Alan L Barton Retirement Acct., Inc.	220.00	
10/06/99	1111	Christina F. Behrens Retirement Acct., Inc.	125.00	
10/06/99	1112	Ted Berndt Retirement Acct., Inc.	250.00	
10/06/99	1113	Frederick & Lois Biederman	250.00	
10/06/99	1114	May Financial Corp for L. Jack Borsum	500.00	
10/06/99	1115	Marjorie Borsum Trust	250.00	
10/06/99	1116	Henry Brumbach	250.00	
10/06/99	1117	Colin Burgess	750.00	
10/06/99	1118	Harold E. Burt Retirement Accts.	150.00	
10/06/99	1119	Paula Carver	250.00	
10/06/99	1120	Thomas F Cullop Retirement Accts	500.00	
10/06/99	1121	Dweyer Family Trust	1,025.84	
10/06/99	1122	Anne L. Evans Retirement Accts	250.00	
10/06/99	1123	Bessie C. Fennell (Nations Bank by Mail)	263.75	
10/06/99	1124	Patricia Fleming	375.00	
10/06/99	1125	Martha C. Haner	300.00	
10/06/99	1126	Sharon E Harrell (Retirement Accts)	500.00	
10/06/99	1127	Herman and Jane Hasselbring	1,000.00	
10/06/99	1128	James F Hawkins	250.00	
10/06/99	1129	Sharon A Herring, (Retirement Accts)	500.00	
10/06/99	1130	Stanley or Rebekah Hime	250.00	
10/06/99	1131	William A Iles Trust	388.75	
10/06/99	1132	John Jacobsen	250.00	
10/06/99	1133	Harry and Marjorie Judy	150.00	
10/06/99	1134	H Jack & Janet L. Judy Trust	300.00	
10/06/99	1135	Kolseth Revocable Trust	200.00	
10/06/99	1136	Catherine Kraus	250.00	
10/06/99	1137	Mary Kraus	185.00	
10/06/99	1138	Willadean Lamotte (Retirement Accts)	500.00	
10/06/99	1139	Barbara Leohwing	500.00	

Appendix C

Date	Check No.	Payee	Ineligible Amount ^{1/}	Paid While in Default ^{2/}
10/06/99	1140	Leatrice Makrouer	255.50	
10/06/99	1141	Susan Martin	250.00	
10/06/99	1142	Peter J. Merkle (Retirement Accts)	500.00	
10/06/99	1143	Charles V. Mullen, Sr	200.00	
10/06/99	1144	Charles C. Mullen, Jr	150.00	
10/06/99	1145	Phyllis Phoa	55.00	
10/06/99	1146	Phyllis Phoa	150.00	
10/06/99	1147	Katie Pike or Anita Kirkwood	150.00	
10/06/99	1148	Kathlee Platte (Retirement Accts)	100.00	
10/06/99	1149	Lynn Queenan (Retirement Accts)	130.00	
10/06/99	1150	Ralph and Marjorie Schockey	120.00	
10/06/99	1151	Ruth B. Setser Rev. Trust	550.00	
10/06/99	1152	Frances R. Shepherd	277.50	
10/06/99	1153	John D Shirley (Retirement Accts,	372.84	
10/06/99	1154	Elliot S. Silverman	250.00	
10/06/99	1155	Jan Silverman	250.00	
10/06/99	1156	William or Jean Sponseller	300.00	
10/06/99	1158	Laura Travis	250.00	
10/06/99	1159	David Watson	250.00	
10/06/99	1160	Maxine Weinberger	250.00	
11/18/99	1236	Leatrice Makrouer	255.50	
12/07/99	1270	Harold E. Burt Retirement Accts.	500.00	
12/10/99	1303	Leatrice Makrouer	255.50	
12/20/99	1001	Howard Weinberger	565.00	
02/02/00	2014	Leatrice Makrouer	511.00	
03/06/00	2023	Leatrice Makrouer	255.50	
04/04/00	2028	Leatrice Makrouer	255.50	
05/08/00	2034	Leatrice Makrouer	255.50	
06/12/00	2042	Leatrice Makrouer	255.50	
07/13/00	2049	Leatrice Makrouer	255.50	
08/01/00	2054	Leatrice Makrouer	255.50	
09/01/00	2060	Leatrice Makrouer	255.50	
Subtotal - Investors			\$ 35,779.86	
Total Ineligible Distributions (Part I)			\$ 200,329.86	\$ 25,000.00

Part II

Ineligible Management Agent Expenditures

Date	Check No.	Payee	Ineligible Amount ^{1/}	Paid While in Default ^{2/}
07/07/00	2046	Mountain Heritage	\$ 485.58	
07/11/00	2048	Mountain Heritage	10,275.55	
01/24/01	2065	Mountain Heritage	1,644.20	
01/24/01	2066	Mountain Heritage	371.20	
02/06/01	2073	Mountain Heritage	950.00	
02/12/01	2076	Mountain Heritage	950.00	
02/26/01	2082	Mountain Heritage	1,739.31	
03/02/01	2085	Mountain Heritage	1,257.39	
03/09/01	2087	Mountain Heritage	1,580.16	
03/16/01	2091	Mountain Heritage	1,268.67	
03/23/01	2092	Mountain Heritage	1,282.75	
03/30/01	2093	Mountain Heritage	2,153.00	
04/25/01	2393	Mountain Heritage	1,298.94	
04/25/01	2394	Mountain Heritage	1,384.75	
04/25/01	2395	Mountain Heritage	1,113.89	
11/01/01	2118	Mountain Heritage	4,120.58	
Subtotal - Mountain Heritage			\$ 31,875.97	
10/05/01	2099	Lisa Kessler	\$ 3,449.11	
10/09/01	2101	Lisa Kessler	1,039.68	
11/16/01	2128	Lisa Kessler	1,349.56	
12/04/01	2133	Lisa Kessler	5,548.86	
01/02/02	2151	Lisa Kessler	6,932.87	
01/18/02	2160	Lisa Kessler	5,971.07	
02/08/02	2171	Lisa Kessler	2,022.97	
02/08/02	2172	Lisa Kessler	2,210.00	
02/26/02	2182	Lisa Kessler	7,204.28	
Subtotal - Lisa Kessler			\$ 35,728.40	
05/15/01	2398	Ward's Painting	\$ 1,094.89	
05/15/01	2399	Ward's Painting	1,311.30	
05/15/01	2400	Ward's Painting	1,418.92	
05/15/01	2402	Ward's Painting	1,985.00	
05/24/01	2407	Ward's Painting	1,131.57	
05/31/01	2411	Ward's Painting	930.00	
06/06/01	2416	Ward's Painting	1,037.73	
06/12/01	2419	Ward's Painting	1,586.98	
06/12/01	2420	Ward's Painting	3,257.00	
06/12/01	2421	Ward's Painting	3,185.00	
06/20/01	2425	Ward's Painting	4,178.00	

Appendix C

Date	Check No.	Payee	Ineligible Amount ^{1/}	Paid While in Default ^{2/}
06/20/01	2426	Ward's Painting	1,638.15	
06/26/01	2429	Ward's Painting	2,266.60	
07/16/01	2444	Ward's Painting	1,201.85	
07/16/01	2445	Ward's Painting	1,608.10	
07/19/01	2447	Ward's Painting	1,368.40	
07/23/01	2451	Ward's Painting	1,601.60	
07/30/01	2452	Ward's Painting	1,572.19	
08/09/01	2460	Ward's Painting	1,754.50	
08/20/01	2470	Ward's Painting	1,732.25	
08/24/01	2473	Ward's Painting	1,368.22	
08/28/01	2475	Ward's Painting	2,239.79	
09/07/01	2479	Ward's Painting	1,329.00	
09/07/01	2480	Ward's Painting	1,204.91	
09/17/01	2488	Ward's Painting	1,237.08	
09/28/01	2491	Ward's Painting	1,265.46	
Subtotal - Ward's Painting			\$ 44,504.49	

Total Ineligible Management Agent Expenditures (Part II) \$ 112,108.86

TOTAL INELIGIBLE EXPENDITURES \$ 312,438.72 \$ 25,000.00

Listing of Discrepancies and Concerns Identified in Monthly Accounting Reports

Identified by the Mortgagee:

October 2000

- Beginning cash and ending cash of \$88.52, even though the report indicated a disbursement of \$40.00.
- The required bank statement was not included.
- Schedule C did not include payables that should be present.

November 2000

- Schedule of Disbursements did not include payment of payables from October.
- The required bank statement was not included.

December 2000

- Questioned the nature and purpose of a \$4,500.00 disbursement for misc. admin.

January 2001

- Questioned the preparation of concrete slabs for a compactor as a routine operating expense.
- Several invoices and disbursements indicated the presence of accounts payable prior to January 2001, but were not noted in previous monthly accounting reports.
- Required an explanation as to why the model apartment unit received cable television service.
- Required the explanation and itemizing of the miscellaneous administrative expense of \$1,800.00 to Mason-Phillips.

Identified by HUD:

March 2001

- Required explanations for several disbursements on Schedule B. Payees included Tampa Bay Fire (\$2,737.60), Mountain Heritage (\$8,078.28), Bay Area Apt. Guide (\$1,000.00), and Mason-Phillips (\$4,000.00).

April 2001

- Required explanations for several disbursements on Schedule B. Payees included Mountain Heritage (\$5,950.58), Mason-Phillips (\$9,000.00), and Bay Area Apt. Guide (\$1,000.00).

May 2001

- Schedule B, Schedule of Disbursements was not provided.

June 2001

- The project occupancy information was incomplete.
- The dollar amount on the Schedule of Disbursements was incorrect.

September 2001

- Required explanations for several disbursements. Payees included Ward's Painting (\$5,036.45), Ultraedge Landscaping (\$4,000.00), and Patty O'Callahan (\$3,000.00).
- Schedule A was not completed properly.

October 2001

- Questioned the reasonableness of Ultraedge, Tree Trimming costs of \$2,000.00 and \$1,630.00.
- Required explanations for several disbursements. Payees included Lisa Kessler (\$3,449.11) and Patty O'Callahan (Unauthorized \$8,385.21)
- Questioned reasonableness of Apartment Finders, Advertising cost of \$3,300.00.

November 2001

- Questioned the reasonableness of Earl's Pool Cleaning maintenance cost of \$2,179.80 and Ultraedge landscaping cost of \$3,000.00.
- Required explanation and breakdown of \$4,120.58 payroll cost

December 2001

- Required explanation of Lisa Kessler payroll cost of \$5,548.86 and Apartment Finders advertising cost of \$3,300.00.
- Questioned reasonableness of carpet cleaner cost of \$2,073.50.

Distribution Outside of HUD

Owner, Ashley Crossings Apartments

Sharon Pinkerton, Senior Advisor
Subcommittee on Criminal Justice

Stanley Czerwinski, Associate Director
Resources, Community, and Economic Development Division
U.S. General Accounting Office

Steve Redburn, Chief Housing Branch
Office of Management and Budget

The Honorable Joseph Lieberman
Chairman
Committee on Government Affairs

The Honorable Fred Thompson
Ranking Member
Committee on Governmental Affairs,

The Honorable Dan Burton
Chairman
Committee on Government Reform,

The Honorable Henry A. Waxman
Ranking Member
Committee on Government Reform

Andy Cochran
House Committee on Financial Services

Clinton C. Jones, Senior Counsel
Committee on Financial Services