Audit Report

District Inspector General for Audit
Pacific/Hawaii District

Report: 98-SF-212-1001 *Issued: March 24, 1998*

TO: Janet L. Browder, Director, Multifamily Housing Division, 9AHM

FROM: Glenn S. Warner, District Inspector General for Audit, 9AGA

SUBJECT: Villa San Carlos Garden Apartments
Multifamily Mortgagor Operations
Santa Cruz, California

At the request of the Multifamily Asset Management Branch of HUD's Office of Housing, California State Office, we conducted an audit of Villa San Carlos Garden Apartments (project 121-44153) whose mortgage loan the U.S. Department of Housing and Urban Development insured under section 236 of the *National Housing Act*.

The report's two findings describe misuse of project assets and problems with the project's physical condition as well as other aspects of the project's management. Within 60 days, please furnish us a status report on (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is not considered necessary for each recommendation in the report. **However, we request that action not be taken on the recommendations until you have consulted with us.**

If you or your staff have any questions, please contact senior auditor Mark Pierce at 436-8101.

Executive Summary

We reviewed operations of Villa San Carlos Garden Apartments. Our objective was to determine whether the use of project assets complied with the regulatory agreement between the owner and HUD. We concluded that the project was not managed in accordance with HUD's requirements. There was unnecessary and unsupported use of assets. In addition, management practices were inadequate for procurement of services and materials, and for handling employee time and attendance records.

Asset Misuse

As the project's management agent, Creative Property Management (CPM) collected or disbursed unnecessary amounts totaling $188,803 from Villa San Carlos Garden Apartments (VSC). Also, the propriety of CPM's receipt and disbursement of an additional $98,377 was not supported. Subsequent to CPM's involvement, the president of the VSC board of directors incurred additional improper expenses of $15,000. These events occurred due to management and owner disregard of HUD requirements and VSC policies, poor oversight by the VSC board, and poor accounting and record keeping. As a result, the project experienced cash deficiencies and deferred maintenance. The level of deferred maintenance more than doubled to over $1 million, resulting in poor living conditions for residents.

Other Deficient Practices

Additionally, we noted that procurement practices were inadequate and the employee time and attendance records appeared to be unreliable. These occurred because of insufficient oversight by the VSC board and poor management practices of the agent.

Auditee Response

With minor exception, the owner generally agreed with the audit's conclusions. CPM declined to comment.

Recommendations

We are recommending that HUD: assure that acceptable and competent management is in place to run the project, obtain compensation for the misuse of project assets, and take other actions to correct the noted problems.

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Acronyms

CPM	Creative Property Management (former management agent/property manager for the project)
HUD	U.S. Department of Housing and Urban Development (insurer of the project's mortgage loan)
OIG	Office of Inspector General, U.S. Department of Housing and Urban Development (performed the subject audit)
USC	United States Code (federal law)
VSC	Villa San Carlos Garden Apartments (the project) or Villa San Carlos, Incorporated (project owner/mortgagor), depending upon the context

Introduction

BACKGROUND

The Project

Villa San Carlos Garden Apartments (project) is a 200-unit housing development located in Santa Cruz, California. The project owner and mortgagor, Villa San Carlos, Incorporated, is a non-profit organization established in February 1971 to provide housing for low and moderate income families and individuals. The mortgagor's articles of incorporation established a three-member board of directors to conduct its affairs.

The project is subject to a mortgage insured pursuant to section 236 of the *National Housing Act*, with a balance of $2,274,836 as of December 31, 1995. In compensation for the insurance, the mortgagor agreed to be subject to HUD regulations over project operations. These requirements are contained or referenced in a contract known as a regulatory agreement.

In addition, the project receives subsidies from HUD for many of its low-income tenants under the section 8 program. Under this program, the mortgagor is contractually obligated to assure the tenants receiving assistance are eligible, that assistance amounts are proper, and that the housing is safe, decent and sanitary.

Management

In February 1993 Victor Camacho, president of the VSC board of directors, and E. R. Silva, president of Creative Property Management, entered into a management certification agreement, a standard HUD form. HUD approved this agreement in May 1993. CPM continued to manage VSC until August 31, 1996, when the agreement was terminated.

CPM was a Fairfield, California-based company operated by E. R. Silva, who was the owner and president. CPM handled no additional HUD subsidized housing projects while managing Villa San Carlos. It was CPM's practice to maintain VSC records at the project site in Santa Cruz, except for payroll records kept in Fairfield.

Benno Pabst, President of U.S. Prime Property Management, began managing Villa San Carlos in September 1996. Mr. Pabst has maintained office space on-site in the project's administration office, and has been given the position of "project administrator." Mr. Pabst does not manage any other HUD subsidized housing projects. HUD has not approved U.S. Prime Property as the management agent of VSC and has taken exception with the cost of the additional position.

Audit Request

On August 20, 1996, the Multifamily Asset Management Branch of HUD's Office of Housing, California State Office, requested that the Office of Inspector General perform an audit of the project. The request cited long-standing issues related to fiscal incompetence or possible misuse of project assets.

AUDIT OBJECTIVES AND SCOPE

Purpose and Extent

We reviewed project operations to determine if the mortgagor's and the management agents' use of project assets complied with the regulatory agreement and other HUD requirements. The audit generally covered the period from February 1993 to August 1996, the period Creative Property Management maintained management control over Villa San Carlos. Audit work was performed intermittently from August 1996 to September 1997.

The primary methodologies for this work included:

- Review of pertinent files on the project and the agent maintained by HUD California State Office, the Villa San Carlos administration office, and Creative Property Management's office.
- Interviews of San Francisco HUD program officials, Villa San Carlos on-site staff, the Villa San Carlos board president, the president of U.S. Prime Property Management, and the president of Creative Property Management.
- Consideration of the project's management control structure and assessment of risk exposure to determine audit procedures.
- Analysis of available audited financial statements of the project.
- Review of project accounting records and substantive tests of selected financial activities and transactions.
- Direct confirmations with selected vendors.

This report reflects our consideration of auditee comments. We obtained written comments from the president of the VSC board of directors (see Appendix 2) and discussed the audit's conclusions in person on January 26, 1998 with the board president, and the project's administrator Benno Pabst and public accountant Dennis Lorette. CPM, the former management agent, ignored our attempts to obtain its comments. The board president advised us that CPM's owner declined to provide comments.

Standards

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

Findings

Finding 1

Agent and Board President Made Unnecessary and Unsupported Use of Project Assets

We concluded that $302,180 of project funds were used for unnecessary or unsupported purposes. CPM improperly received or disbursed $188,803. CPM also received or disbursed an additional $98,377 in unsupported amounts. After CPM's management of the project ended, the VSC president of the board of directors incurred additional ineligible expenses of $15,000. These events occurred due to management and owner disregard of HUD and VSC policies, lack of oversight by the VSC board, and poor accounting and record keeping. As a result, the project operated with cash deficiencies and suffered deferred maintenance; causing tenants to reside in unacceptable conditions and unnecessarily increasing HUD's insurance risk. The level of deferred maintenance more than doubled in less than four years to over $1 million, resulting in poor living conditions for residents.

Requirements on Asset Use

The regulatory agreement between HUD and the project owner, Villa San Carlos, Inc., was signed on July 12, 1971. The agreement states that the owner cannot encumber or pay out any project funds, except for reasonable operating expenses and necessary repairs. Payments for materials and services shall not exceed amounts ordinarily paid for such items. The books and accounts of the project's operations are to be kept in accordance with HUD requirements. Also, the owner is to maintain the mortgaged premises, accommodations, grounds, and equipment in good repair and condition.

E. R. Silva, President of CPM, and Victor Camacho, president of the VSC board, had entered into a management certification agreement on February 10, 1993. The agent agreed to assure that all expenses of the project are reasonable and necessary, exert reasonable efforts to maximize project income, take advantage of all discounts, and maintain documentation supporting their endeavors. The agent also agreed to establish and maintain the project's accounts, books and records in accordance with HUD's requirements, generally accepted accounting principles, and in a condition that will facilitate audit. The agent also agreed to comply with the project's regulatory agreement, HUD handbooks and notices, and HUD requirements regarding payment and reasonableness of management fees and other charges. HUD Handbook 4381.5 REV-2, *The Management Agent Handbook*, establishes criteria for determining eligible management fee and charges.

Section 421 of the *Housing and Community Development Act of 1987* (Public Law 100-242) contains double damages civil remedy for unauthorized use of multifamily housing project assets and income, codified under United States Code, title 12, section 1715z-4a. Under this statute, assets used in violation of the regulatory agreement, as well as unsupported uses of assets, are subject to civil remedy. In addition, the 1989 *HUD Reform Act* provides for civil penalty amounts ranging from $1,000 to $25,000 per violation on program participants who knowingly and materially violate program statutes, regulations and handbook requirements.

CPM improperly received project funds in excess of actual cost incurred and authorized management agent fees. In addition, the agent and the owner of VSC made unnecessary and unsupported disbursements of project funds to vendors. We have categorized these violations of the regulatory agreement as follows.

Issue		Unnecessary Amounts	Unsupported Amounts
I	Management fees	$32,933	$29,747
II	Payroll	117,187	51,944
III	Security deposit transfers	13,000	
IV	Workers compensation insurance	23,917	4,867
V	Miscellaneous disbursements	1,766	11,819
VI	Disbursements by owner	15,000	
	Totals	$203,803	$98,377

I. MANAGEMENT FEES

Between 1993 and 1996 CPM received management fees of $32,933 in excess of HUD directives, including the HUD handbooks and the management certification. The agent also collected another $29,747 in unsupported management fees. Based on the documentation available, the agent cannot show that the amount was reasonable and necessary for the project.

The management certification provided that the agent receive 13 percent of residential, commercial, and miscellaneous income collected. HUD's approval on May 19, 1993 limited the fee to 13 percent of residential and miscellaneous income collected. The agreement states that if the agent is notified of an excessive management fee, within thirty days the agent will reduce the compensation to an amount HUD determines to be reasonable and refund all excessive fees collected. Also, HUD may adjust the management fee percentage each time HUD approves a rent increase.

HUD Handbook 4381.5 REV-2, *The Management Agent Handbook*, established criteria for determining how the management fee is computed. Income for the purpose of determining a fee does not include: interest earned on invested security deposits, reserves, or other project funds; section 8 special claims for unpaid rent, vacancy loss, debt service, or resident damages; HUD flexible subsidy funds; refunds from property tax or utility rate appeals; proceeds from property damages or liability insurance policies; recovered legal fees and court cost; or replacement reserve and residual receipts reimbursements.

Excessive Fees

From 1993 to 1996 CPM received $32,933 in excessive management fees. This includes $21,632 collected as the monthly management fees and $11,301 in back-fees and adjustments in addition to the monthly fee.

The management certification stated that CPM was entitled a fee of thirteen percent of residential rent income and miscellaneous income collected. However, with approval of an October 1993 rent increase, HUD imposed a dollar limit. The limitation allowed CPM to continue to charge the project thirteen percent of income collected, but not to exceed $9,000 per month. Beginning in 1996 HUD allowed an increase to $10,000.

Management fees collected by the agent for the period of October 1992 to September 1993, before the fee limitation was set into place, were computed based on thirteen percent of income collected. Then from October 1993 to August 1996 CPM charged the maximum cap amounts.

However, the documentation provided by CPM showed that certain income was improperly included into the agent's fee calculations. The agent did not remove not-sufficient-fund (NSF) rent checks from his calculations. When the NSF checks were honored in succeeding months they were included again as rent collected, which resulted in the agent double charging a fee on that income. In addition, ineligible income was used in the agent's computation, including: excess income due HUD, replacement reserve withdrawals, security deposit interest, property tax refunds, transfers of funds between VSC accounts, and discrepancies which did not match the project accounting reports.

- The agent's documentation showed that for each month between February 1993 and May 1996, excess income due HUD was included into the fee computation.

- In April 1993 the agent listed $13,005 as income collected and included the amount into the fee calculation. The VSC monthly accounting reports showed that this amount was actually a transfer from the savings account. There were similar instances in which transfers between accounts were listed as income: February 1993, March 1993, May 1993, June 1994, and April 1996.

- In May 1993 laundry income of $1,137 was included twice in the fee calculation, once as laundry income and then again as unidentified miscellaneous income. Similar errors occurred in September 1993, October 1993, March 1994, October 1994, December 1994, September 1995, October 1995, December 1995, and April 1996.

- In July 1993 $14,600 in withdrawals from the replacement reserve were included in the agent's determination of the fee. Replacement reserve withdrawals were also included in fee computations for March 1993, April 1993, August 1993, October 1993, February 1994, November 1994, September 1995, and April 1996.

The amounts the agent computed as management fees were to be limited by the fee ceiling. Fees computed based on eligible or ineligible income in excess of the ceiling were correctly not collected by the agent in November 1993, and from May 1994 to December 1995. However, fees based on eligible income were below the ceiling in October 1993, December 1993 to April 1994, and January 1996 to June 1997. Since the agent charged the amount of the ceiling during these months, the difference of $6,441 between the proper fee and the ceiling was solely attributable to fee calculations based on ineligible income. Before the fee ceiling was established, the agent received excessive fees based on ineligible income each month. This resulted in additional ineligible fees of $15,191 for the period of October 1992 to September 1993. Thus, the agent collected excessive monthly management fees of $21,632 during his term as the VSC agent.

Period	Fee Based on Eligible Income	Fee Ceiling	Monthly Fee Collected	Excessive Fee
Oct. 1992 to Sept. 1993	$86,397	none	$101,588	$15,191
Oct. 1993	7,234	$9,000	9,000	1,766
Nov. 1993	9,482	9,000	9,000	0
Dec. 1993 to April 1994	42,273	45,000	45,000	2,727
May 1994 to Dec. 1995	195,839	180,000	180,000	0
Jan. 1996 to June 1996	58,052	60,000	60,000	1,948
July 1996 to Aug. 1996	23,125	20,000	20,000	0
				$21,632

In addition to the above monthly fees, the agent received back fees and adjustments of $11,301. Although CPM had already received the maximum fee allowed, the agent still collected additional fee adjustments of $2,000 on November 17, 1994 and $1,300 on December 28, 1995. The agent also collected back fees of $958 on May 2, 1996, $5,000 on August 15, 1996, and $2,043 on September 1, 1996.

Based on documentation provided by the agent, the back fees for the period of February 1993 to September 1993 were based on ineligible income. In addition, the agent had already been paid the maximum fee allowed under the $9,000 ceiling between October 1993 and December 1995. Thus, any back fees accrued by CPM during this period violated the HUD-imposed limitation. The agent stated that he believed the fee limitation imposed by HUD was actually $10,000 per month from when the maximum limit was first imposed, so he charged that amount. However, CPM could not substantiate this assertion. Thus, the back fees and adjustments received by CPM totaling $11,301 were excessive.

Unsupported Fees

The agent also collected unsupported management fees that included $749 collected based on unsupported income, and questionable fees of $28,998 collected for the period of October 1992 to January 1993.

CPM included inadequately supported miscellaneous receipts of $1,910 for March 1993 and $3,849 for February 1993 in the computation of management fees. CPM received $749 in fees based on these receipts. These miscellaneous receipts were included in the VSC accounting reports, but there was no documentation to explain the income source. As a result, the agent cannot show that the fees were based on eligible income.

Also, the agent received fees totaling $34,156 for alleged services between October 1992 and January 1993. The agent collected these fees for the period in question on May 19, 1993, the date HUD approved the management certification. The management agreement between CPM and the owner was dated September 15, 1992, corresponding with the amount collected. However, the owner did not sign the management certification until February 10, 1993. VSC had previously attempted to obtain HUD approval to allow CPM to manage the project, but HUD rejected the request on October 9, 1992. Due to HUD's rejection of CPM, the agent was not supposed to provide management services to the project. However, HUD officials told us that since CPM was eventually approved, the agent could collect fees for the previous period in which he was providing management services to VSC.

Nevertheless, we noted no substantive evidence that CPM was providing management services to the project until February 1993. There was no documentation available to show that CPM was preparing or signing project related reports or correspondence until February 1993. In addition, CPM did not establish a payroll account or bank accounts for the project until February 1993. The agent waited until February 1993 to charge the project for his administrative assistant. Also, letters subsequently issued by CPM to third parties implied that CPM did not begin handling VSC affairs until February 1993. Of the $34,156 charged for the period in question, $5,158 was based on ineligible income with which we already took exception above, leaving a net amount of $28,998.

II. PAYROLL

The project paid $117,187 for unnecessary payroll-related expenses to the agent and insurance vendors between February 1993 and August 1996. The agent also collected $51,944 for payroll without maintaining proper documentation to show that the amount was proper.

Description	Topic Amount	Itemized Amount
Non-project employees	$85,994	
Consultant		$17,625
Agent's wife		15,773
Agent's assistants		33,856
Employer taxes		2,437
Health benefits		13,546
Worker's compensation insurance		2,757
Unnecessary disbursements	31,193	
Excessive transfers		7,431
Payroll advances		1,400
Double payments		11,576
Excess taxes		9,154
Excess processing fees		1,632
Unsupported payroll costs	51,944	
Payroll processing		18,671
Employee payroll 1993		26,399
Taxes 1993		6,874
Totals	$169,131	$169,131

HUD Handbook 4381.5 Rev-2, states that costs covered by the agent's monthly fee include: the selection and establishment of an accounting system and internal management control procedures; visits to spot check performance of on-site staff, bookkeeping expenses attributable to the agent's company; and overhead expenses (such as the agent's supplies and equipment, transportation, and phone calls to project, regularly scheduled long distance calls from project to agent, office space, data processing, etc.). Thus, expenses covered by the monthly fee include salaries, fringe benefits, office expenses, fees, and contract costs for the following activities: designing procedures/systems to keep the project running smoothly and in conformity with HUD requirements; recruiting, hiring, and supervising project personnel; training for project personnel that exceeds the line item budget for training expenses; monitoring project operations by visiting the project or analyzing project performance reports; and analyzing and solving project problems.

The handbook also states that the agent may not impose surcharges or administrative fees in addition to actual costs of reimbursable expenses. The cost of performing front-line management functions off-site may not exceed the total cost of performing these functions at the property. An agent's generalist staff must document hours spent and duties performed on front-line activities for each project and those spent on the central office functions.

Non-project Employees

The agent collected and paid out $85,994 from the project for employees not performing front-line services for the project. This included the employees' salaries of $67,254, payroll taxes, health benefits, and workers' compensation expense of $18,740.

The agent collected $67,254 from the project for the entire salaries of CPM employees not performing any substantial front-line project duties. This included a consultant, Charles Amaral; the agent's wife; and three administrative assistants. These costs were to have been borne by the monthly management fee.

Charles Amaral was employed by CPM between June 1993 and February 1994 at a cost to the project of $17,625. According to the agent and project personnel, Mr. Amaral worked at the project site to help convert the project over to CPM's operating and reporting procedures. This included training and supervising employees on the implementation of the agent's procedures and establishing computer systems. The consulting services of Mr. Amaral were not listed as a separate expense on the monthly accounting reports submitted to HUD, but were charged to the project for eight months through payroll charges.

The functions performed by Mr. Amaral were management in nature which the project already compensated for as part of the agent's monthly fee, with the possible exception of implementing and training the project staff on the computer system. However, no documentation was available to separate the effort attributable to possible eligible activities. Still, the effort to implement the agent's computer system and train the three members of the office staff would not have been material. Thus, we take exception to the entire amount.

The agent collected $15,773 for compensation to his wife, who was supposedly acting as a consultant for VSC between August 1995 and August 1996. The agent stated that as a consultant, his wife spent two days a month preparing and reviewing the monthly ABC report required by HUD. However, the VSC occupancy specialist prepared the two most extensive portions of the report, which showed the project's disbursements and accounts payable. The agent's wife was reviewing the occupancy specialist's work and preparing the summary page of the ABC report. Time spent reviewing the work of the occupancy specialist was supervisory activity which is included as part of the management fee.

The agent charged $33,856 to the project for compensation paid to his administrative assistants. The agent maintains that these employees were preparing and reviewing the monthly accounting reports required by HUD, before his wife performed these functions. He also said they performed additional unspecified and undocumented project-related activities.

The agent stated that the three employees replaced one another, performing the same function. However, the agent only had the personnel file for one. Her application to CPM on January 5, 1994 was for a receptionist position. Her prior experience was in sales and as a receptionist. The résumé prepared by the agent, upon her termination, listed her as an administrative assistant. The résumé listed some bookkeeping activities, but it was not evident what the nature of these activities were or whether they were performed for the project or the agent. The administrative assistant declined to speak with us about her duties at CPM.

Subsequent to the agent's management of the project, the occupancy specialist has prepared the entire monthly report. She spends less than half an hour preparing the summary page of the report. The VSC staff were unaware that the agent's wife or assistants had ever assisted with the monthly report. In addition, on April 10, 1993 the agent stated in a letter to HUD that all project accounting, except for the general ledger, would be included as part of the management fee. We consider the charges for the agent's wife and assistants to prepare a part of the monthly report as unreasonable, since the occupancy specialist could have prepared the entire report at no additional cost to the project.

The project paid CPM at least $2,437 in employer payroll taxes for the three administrative assistants. This amount includes $1,975 in FICA and $462 in Medicare. We found no evidence, however, that payroll taxes for Charles Amaral or the agent's wife were charged to the project.

The project also paid $13,546 for the health benefit costs of non-project employees: $5,193 to Pacific Care for the agent's personal health coverage between June 1994 and August 1996; $1,797 to Pacific Care for an administrative assistant's health coverage between September 1994 and October 1995; $6,343 to Pacific Care for health benefits of an agent employee, whose salary was not charged to the project, between June 1994 and June 1996 (project staff could not identify this person as ever having worked for or having been associated with the project); and finally, $213 was paid to Ameritas Insurance for an administrative assistant's dental benefits between May 1994 and September 1995.

The project paid an estimated $2,757 for the workers' compensation insurance expense of the non-project employees. The documentation provided by the VSC workers' compensation vendor, California Indemnity Insurance (CII), listed three such employees under the agent's workers' compensation policy between 1993 and 1994. The premium paid is based on the actual payroll incurred, so the cost increases with additional payroll. We estimate that as much as $2,757 may be attributable to the three employees, based on an average percentage for all employees. We realize that certain employees may have differing rates, so the actual amount may be lower, but the vendor could not provide information on rates charged for individual employees.

Unnecessary Disbursements

CPM collected or paid $31,193 from the project for other unnecessary payroll related expenses. This amount includes excessive payroll transfers, double collections of employee deductions, excess payroll taxes collected, and unreasonable payroll processing fees. In addition, CPM provided payroll advances to VSC staff directly from project accounts and never credited the project's payroll for these amounts.

The agent transferred excessive amounts totaling $7,431 from project accounts to the CPM payroll account. The transfers included $1,500 on July 27, 1994, $4,238 on August 30, 1994, and an excess $1,693 in September 1994. The bank statements and payroll reports show that all payroll expenses due had already been collected. Thus, the additional payroll transfers are unreasonable.

CPM paid payroll advances of $1,400 directly from the project operating account. The advances included $600 on May 16, 1995 and $800 on September 22, 1995 (checks 1847 and 1993). The payroll reports did not reflect any reduction in the employees' salaries after the advances. As a result, the project paid for the employees' salary twice.

CPM double charged the project $11,576 for employee deductions. Specifically, the agent collected deductions directly from the project as payroll expenses which were also deducted from the employees' gross salary for payments to the Internal Revenue Service and the Family Support Division for two project employees between January 1994 and August 1995.

The project paid the agent $9,154 in excessive payroll taxes. The payroll reports were prepared by an independent payroll processing vendor and listed the amounts that were due as payroll taxes for each pay period. However, amounts paid to the agent for payroll taxes between August 1993 and December 1994 exceeded the amounts listed on the payroll reports by $9,154. This included amounts in excess of the actual tax of: $1,137 on August 15, 1993, $2,019 on September 15, 1993, $1,230 on March 1, 1994, $800 on May 1, 1994, $1,000 on August 1, 1994, and $2,968 on December 31, 1994.

The agent received excessive payroll processing fees between May 1996 and August 1996 totaling $1,632. CPM contracted through a vendor to process the payroll, issue payroll checks, and provide payroll reports. According to CPM, the amounts collected from the project consisted of a flat two percent fee on payroll; however this exceeded the amounts paid to the payroll vendor. Between May

1996 and August 1996 CPM collected $2,164 in processing fees. The invoices and payroll reports provided by the vendor showed that they only received $532 for the period. The additional fees were collected by the agent to allegedly reimburse CPM for additional time spent processing the payroll. However, CPM kept no records on time spent processing the VSC payroll, and we believe it is unreasonable to charge the project for additional payroll processing when the project is already paying a payroll processing vendor. Any time spent by the agent reviewing the payroll reports or time cards would be supervisory activity which is compensated by the management fee.

Unsupported Payroll Costs

The management certification states that the agent agreed to assure that all project expenses are reasonable and necessary and to maintain copies of such documentation. Also, the agent agreed to establish and maintain the project's accounts, books and records in accordance with HUD's administrative requirements, generally accepted accounting principles, and in a condition that will facilitate audit. However, the agent collected $51,944 from the project for unsupported payroll related expenses, including payroll processing fees, employee salaries, and taxes.

The agent collected $18,671 in payroll processing fees from VSC between 1993 and April 1996 in addition to the amounts listed on the payroll reports as having been paid directly to the vendor after November 1995. The agent did not maintain documentation to support the reasonableness of the $18,671 charge. Part of the unsupported amount was attributed to the cost of having the payroll processing vendor, Payroll Masters, prepare the payroll reports. Amounts paid to the payroll vendor to prepare the payroll reports would be acceptable project expense. However, the agent has included an additional ineligible surcharge on payroll as his own payroll processing fee (see ineligible processing discussed earlier). However, due to the lack of documentation, all amounts paid to the vendor during the period February 1993 to April 1996 could not be determined.

The agent was paid $26,399 for payroll without maintaining adequate documentation: $24,691 for pay dates of February 16, 1993 to April 1, 1993 and $1,708 for pay dates of April 15, 1993 to June 15, 1993.

According to monthly accounting reports and bank statements, the agent was paid $26,691 for employees' salaries between February 16, 1993 to April 1, 1993. However, no payroll records were available to show that these costs were only for front-line employees. Since we already took exception to the salary attributable to a non-project administrative assistant (identified from information provided by the insurance carrier), the net amount considered to be unsupported is $24,691.

There was additional unsupported payroll of $1,708 for the pay dates of April 15, 1993 to June 15, 1993. A comparison of the amounts listed on the payroll reports to the amounts paid and listed on the monthly accounting reports as employee salary shows a discrepancy of $1,708. There was no support available to confirm if the amount paid to the agent was attributable to project employees.

The agent collected $6,874 in unsupported employer payroll taxes from VSC in 1993. The payroll taxes for the pay dates of February 16, 1993 to June 15, 1993 were not listed on available payroll reports.

III. SECURITY DEPOSIT TRANSFERS

HUD Handbook 4370.2 REV-1, *Financial Operations and Accounting Procedures for Insured Multifamily Projects*, dated May 1992 states that security deposit funds cannot be commingled with operating or agent accounts. Disbursements from the account can only be for refunds to tenants or payment of appropriate expenses incurred by the tenant. These disbursements must be supported by approved invoices and/or bills.

The agent improperly transferred $13,000 from the VSC security deposit account to his own account between 1993 and 1995. This included $8,000 on April 7, 1993 sent to the agent's payroll account even though all payroll due during this period had been collected from the operating account. On July 27, 1994 the agent was responsible for a bank-originated withdrawal of $2,000 from the market rate security deposit account. This amount was not issued as a check to a vendor or tenant, and was not re-deposited into one of the project's accounts. In addition, on September 7, 1995 $3,000 was transferred from security deposit account to the agent. There was no apparent legitimate basis for these transfers.

IV. WORKERS' COMPENSATION INSURANCE

The agent collected $26,039 in 1996 for excessive and unsupported workers' compensation insurance charges. In addition, in 1995 the agent failed to obtain a refund of approximately $2,745 for the project.

In 1996 the agent collected $26,039 for workers' compensation insurance from VSC. Of that amount, $21,172 was excessive and $4,867 was for unsupported payments. The agent claimed that he had made payments to the workers' compensation vendor, California Indemnity Insurance, for the project's employees. The only documentation that the agent could provide was a rate proposal from California Indemnity Insurance (CII) which would have required deposits and payments matching the amounts CPM collected from VSC.

The $26,039 consisted of: $6,039 paid to CPM on check 2183, dated February 15, 1996; $5,000 transferred to the agent on May 21, 1996; $7,500 paid to the agent on check 2285, dated May 16, 1996; $2,500 transferred to the agent in July 1996; and two payments of $2,500 each were issued on checks 2365 & 2342 in July 1996. The latter two checks were accepted by the bank without a payee listed and the endorsement on the back of the check. The agent stated that these payments were for workers' compensation insurance. However, anyone may have cashed these two checks.

The workers' compensation vendor for VSC, California Indemnity Insurance (CII) could only provide insurance policy documentation up to February 1996. The policy had been terminated after February 1996, and no new policies had been established between February 1996 and August 1996. The project's insurance agent maintained that the workers' compensation insurance was subsequently provided by Golden Eagle Insurance. Two Golden Eagle representatives independently stated that the company held a workers' compensation policy with CPM between February 1996 and August 1996. They stated that CPM only paid $4,867 for the policy during the entire period. The vendor required a notice of consent from CPM to reveal any additional information, but the agent did not forward the consent form we provided. Thus, we consider the $21,172 collected for workers compensation insurance excessive. The remaining $4,867 is unsupported because CPM provided no documentation to show the policy was only for project employees.

The agent did not obtain an estimated refund of $2,745 that had been available to the project. The 1995 workers' compensation premium paid to CII was based on an estimate of payroll for the year. At the end of the year CII would normally conduct an audit of actual payroll and determine if any adjustments to the premium were required. CII representatives stated that CPM had not sent the payroll documentation. As a result, the 1995 premium paid was closed based on the earlier payroll estimate. The project could have received a refund or credit if the actual payroll was below the estimated payroll. Based on eligible employee compensation for the period, we estimate that the project would have been entitled to a refund of $2,745.

V. MISCELLANEOUS DISBURSEMENTS

The agent collected $1,766 in other excessive reimbursements from the project. In addition, the agent collected $11,819 from the project without maintaining proper support to demonstrate the reasonableness of the payments.

The agent made two transfers of $2,000 from the VSC operating account in April 1996. The first $2,000 collected on April 1, 1996 was a legitimate collection for payroll that was due for that period. The second collection of $2,000 on April 17, 1996 was listed in the monthly reports submitted to HUD as reimbursements to CPM, for payments made on behalf of the project to Colonial Pacific and CA Dental. However, the amount transferred to CPM for the project's Colonial Pacific expense had already been collected by the agent from the project's operating account in February 1996. In addition, one of the payments to CPM for the project's CA Dental expense had already been collected from the project's operating account in March 1996. Documentation provided by the vendors confirmed that CPM made only one other payment on behalf of the project, totaling $234. Subsequent account information CPM provided to us for activity between CPM and VSC did not list the April 17, 1996 payment for $2,000. Thus, we consider $1,766 ($2,000 less $234) to be excessive.

Additional payments and transfers of $11,819 were made to the agent with no support showing they were proper uses of project funds. On February 22, 1993 $3,829 was transferred to the agent, even though this same amount had already been paid by VSC on check 1001 during the same month. On December 24, 1993 $2,000 was transferred from the operating savings account. Then on January 6, 1994 $1,798 was transferred from the operating savings account. On December 27, 1994 another $1,500 was transferred from the project to the agent. On June 20, 1994 $2,007 was listed as a deposit posted incorrectly and transferred to the agent, without any support to show why CPM was entitled to the funds. On November 17, 1994 $685 was paid to CPM on check 1605. The monthly report submitted to HUD listed that this amount was paid to Tiger Software. There was no documentation to support any of these payments. The agent told us that all transfers were reimbursements of project expenses paid by CPM, but he could not provide sufficient information or documentation to show that they were for necessary project purposes.

VI. DISBURSEMENTS BY OWNER

The president of the VSC board of directors made an inappropriate disbursement of $10,000 in 1996 for an appraisal of the project. In addition, starting May 1997 the owner began paying (and, we have been advised, continues to pay) an unauthorized management agent $5,000 a month. This activity occurred after CPM stopped providing management services for the project.

The president paid $10,000 out of project funds to First Western Bank for an appraisal of the project in anticipation of refinancing the project. This was done without informing HUD or obtaining its approval. Upon learning of president's intent to refinance, HUD specifically prohibited VSC from prepaying the loan. (The deed of trust note for VSC states that the debt evidenced by the note may not be prepaid, either in whole or in part, until the final maturity date without the prior written approval of HUD.) Since there was no authorization to sell or refinance the project, there was no need to incur the expense of an appraisal. Further, the board president advised us that the appraisal report has never been received. Thus, the project received no benefit from the $10,000 disbursement.

The president also authorized monthly payments of $5,000 for management services to Benno Pabst of Prime Property Management. However, HUD had already rejected the agent's application to become the management agent of the project. (The regulatory agreement states that the owner shall provide for the management of the project in a manner satisfactory to HUD.) Mr. Pabst was rejected because he lacked the proper experience, HUD could not confirm his references, and Mr. Pabst did not respond to HUD's questions concerning the project's deficiencies. Also, HUD told the president that the compensation for Mr. Pabst, combined with the salary of the resident manager, was not a reasonable expense for on-site management. HUD informed the VSC board that they would be held personally responsible for any payments made to Pabst using project funds. Despite HUD's warning, the president has made monthly payments of $5,000 to Mr. Pabst beginning on May 15, 1997. The president labels Mr. Pabst's position as "project administrator."

EFFECTS

The unnecessary and unsupported uses of project funds had significant effects on the low-income housing project.

Cash Shortages

During the period of CPM's management, the project had serious cash problems. The December 31, 1995 financial audit shows that the project had a cash deficit of $6,322 and a surplus cash[1] deficiency of $57,864. The project often had little or no cash while there were significant accounts payable. Based on reports submitted to HUD between December 1994 and August 1996, the project had an average accounts payable balance of $49,588. From February 1993 to August 1996 the operating account had deficits twenty-one times. This forced the project to take funds from other project accounts, including the tenant security deposit accounts. The poor financial status of the project increased the possibility that the project may default on its mortgage payments, thus increasing HUD's risk.

Reports submitted to HUD misrepresented the balance of security deposits held in trust for residents.

The VSC tenant security deposit account was not maintained at a level to cover the liability as required by the regulatory agreement. The account is to contain funds held in trust for the project's tenants. Monthly reports submitted to HUD showed that the balances in the security deposit accounts were at the level of the liability until September 1996, after the agent left. However, contrary to these reports, security deposit bank statements showed that the balance was below the liability between May 1993 and February 1997. The deficit in the account ran over $11,000 before CPM concluded its management. This deficit occurred because security deposit funds were being transferred to the VSC operating accounts and directly to CPM. Due to the poor fi-

[1] HUD defines surplus cash as the amount of cash in excess of that necessary to be on hand for project operations. For non-profit owners such as VSC, surplus cash is to be deposited in a restricted project account.

nancial condition of the project, the shortage could not be restored to the account until February 1997.

Depleted Replacement Reserves

Operating account deficiencies caused by improper project disbursements also appear to have led to the misuse of the replacement reserve. The project withdrew a total of $6,527 from the replacement reserve account for transfers to the operating account for non-existent expenses.

The regulatory agreement states that the owner shall establish and maintain a reserve fund for replacements in a separate account with the mortgagee. Disbursements from the fund may be made only after receiving written consent from HUD. Handbook 4350.1 REV-1, *Multifamily Asset Management and Project Servicing*, details the requirements for requesting withdrawals from the reserve fund. All requests to HUD are to be in writing and provide a detailed description of work done or to be done. If the withdrawal request is a reimbursement for work that has been done, a copy of the invoices should accompany the request.

The project requested permission to withdraw $3,484 for a water softener purchased with check 1214, dated September 10, 1993, by submitting an invoice and the check stub to HUD indicating payment. Based on this documentation, HUD approved the withdrawal from the reserve on September 30, 1993. However, the check was subsequently voided. There was no subsequent payment to the vendor to substitute for the voided check, and we found no evidence that a water softener was purchased subsequently. CPM provided no response to our inquiries concerning the withdrawal.

In addition, between 1995 and 1996 VSC made two requests to withdraw a total of $27,705 for landscaping performed by Reyna's Lawn Care. The first request included a payment of $6,125 on check 2004, dated October 6, 1995. The second request included payments of: $3,000 on check 2054, dated November 1, 1995; $3,000 on check 2031, dated October 24, 1995; $3,000 on check 2167 dated February 1, 1996; $500 on check 2168, dated February 1, 1996; and $12,080 on check 2215, dated March 10, 1996. HUD approved the requests based on the invoices and check stubs submitted. However, the accounting reports showed that VSC only paid $24,662 to Reyna's Lawn Care between 1995 and 1996, $3,043 less than the amount withdrawn from the reserve. The difference occurred because checks 2004 and 2215 were voided. New checks were then issued for smaller amounts.

Attached to the requests to withdraw funds from the reserve account were certifications stating that any overpayment of funds resulting from errors in calculations or for any ineligible reserve for replacement items will be promptly returned. These certifications were signed either by the project's resident manager or the management agent.

Deferred Maintenance

The improper uses of project funds were at the expense of adequate project maintenance. By the end of the management term of CPM, the project's physical condition had deteriorated to an unacceptable level. The unsatisfactory condition of the project continued under Pabst's management.

A physical inspection performed by HUD in August 1993 found the cost to bring the project into satisfactory condition was $417,500. The report identified deficiencies with the boilers, playground area, roofs, driveways, walkways, landscaping, sprinklers, exterior lighting, and exterior painting. In 1995, an owner-commissioned study concluded that the cost of fixing the project was $731,150.

Deferred maintenance more than doubled to one million dollars in less than four years.

Another HUD physical inspection on March 18, 1997 gave VSC an unsatisfactory rating. Due to continued deferred maintenance, the estimated cost to bring the project into proper condition had increased to $1,019,838. The inspection report required the owner to immediately respond to the poor living conditions of the tenants. The report blamed poor maintenance and management for the condition of the project, including inadequate preventive maintenance, unqualified personnel, and lack of maintenance supplies. The deficiencies cited in the 1993 report remained. In addition, the report listed new problems with the plumbing, periodic flooding, heating, asbestos, electrical fixtures, doors, windows, poor floor covering, ceiling stains, exhaust fans, splash-blocks, patio fences, decks, and refrigerators.

The project's poor condition continued under Pabst's management. The mortgagee's October 1997 inspection noted deferred maintenance and rated the overall condition of the property as "unsatisfactory." HUD offered to provide funds to fix the project, but the owner has withdrawn its application for these funds. The owner proposed to use the money from the project's reserve for replacements, but HUD believed this was only a fraction of what is needed.

Unit Vacancies

While CPM was managing VSC, the project experienced prolonged vacancy periods of some of its housing units. According to the project's occupancy reports from June 1995 and August 1996, units would remain vacant for an average of forty days, even though there was a waiting list for new tenants. Nine units were vacant sixty days or more. Since CPM stopped managing VSC, the vacancy period has improved but remained high, dropping to an average vacancy of thirty days. According to HUD, units should not remain vacant for more than two weeks. The long vacancies caused the project to incur unnecessary rent losses. Lost rental income between June 1995 and March 1997 was approximately $28,000 (or to the extent of any vacancy claims for these units under the section 8 contract, HUD paid additional subsidies.) The president of CPM and the VSC staff blamed the financial deficiencies of the project for the vacancy problems and the deferred maintenance. The project could not buy materials to make needed repairs in advance or in bulk due to the project's cash flow problems and poor credit history.

We requested maintenance reports for 15 of the long-vacant units. The project administrative staff could not locate these documents. While the resident manager found some documentation, he was unable to produce repair schedules or work orders. The documentation provided consisted of brief lists of repairs performed on all but two of the units. The reports did not show dates items were repaired or replaced, who performed the repairs, a list of supplies used, or indication of management review. Thus, the available reports were insufficient to determine whether or when the needed work had been performed or whether there had been proper supervision over the work.

CAUSES

There were several reasons why there were unnecessary and unsupported uses of project assets: poor accounting records, the bypassing of VSC management policy, poor oversight by the VSC board of directors, and management's disregard of HUD requirements.

Poor Accounting Records

The agent did not maintain proper accounting records. Invoices and bills were missing from the project's files. Some canceled checks and most transfer notices were not available at the project or the agent's office. General ledger reports were either missing or had not been prepared. There were no general ledger reports prepared for 1996 through August 1996 when CPM stopped managing the project, nor were any prepared after Benno Pabst of U.S. Prime Property Management began managing the project. The W-2 employee payroll reports for 1993 and 1994 were not available. Personnel files were not available and CPM did not provide payroll documentation to the project. The lack of documentation made it difficult for project staff to determine the eligibility of disbursements. Thus, records were not in condition for an efficient audit. In many instances, we had to contact vendors directly to confirm the legitimacy of transactions. Also, since no general ledger statement was prepared for the year ended December 31, 1996, the owner had not submitted audited financial statements that were due by March 1, 1997.[2]

[2] The 1996 audited financial statements were issued in January 1998. The public accountant's report gave a disclaimer of opinion on the financial statements because $157,405 of project expenditures recorded for the year could not be adequately accounted for. This was because of poor oversight by the board of directors and the lack of an effective system of control. The audit was also significantly restricted because there was no access to records controlled by former management agent CPM.

The agent was not able to produce his own accounting records to support amounts he had collected from the project, other than his monthly management fee and most payroll costs. CPM did not maintain invoices or bills for expenses supposedly paid directly on the project's behalf. CPM did not maintain accounting reports or ledgers separate from the project's. This made it impractical for the agent to support the propriety of many collections from the project's accounts.

Bypassing VSC Policy

The agent had the ability to transfer or pay amounts from the project's accounts without obtaining the proper concurrence of project officials. VSC policy required the signature of both a CPM representative and the project's resident manager to make disbursements from project accounts. However, the agent was able to make transfers from the project accounts with only his authorization. In addition, the bank accepted checks from project accounts with the signatures of the agent and his wife alone. The resident manager stated that CPM often did not provide him with documentation to support the disbursements that he was approving. The agent's ability to disburse project funds to himself and vendors, without proper review by VSC staff, was a significant control weakness that resulted in improper disbursements.

Poor Oversight

The VSC board of directors was not sufficiently involved in the project's financial affairs. VSC policy states that all purchases over $1,000, with the exception of the normal recurring monthly expenses, were to be approved by the treasurer or president of the board in writing. Project staff could not provide documentation to support board approval for purchases over $1,000. Management stated that the president of the board would approve items orally; but the president stated that he often did not have time to approve expenses, that he was left out of the decision making process, and that he was not aware of the agent's activities. Nevertheless, the owner is responsible for the agent's actions.

Disregard of HUD Requirements

The owner largely ignored HUD Office of Housing demands to return ineligible withdrawals to the project, correct physical deficiencies, obtain proper management, and provide explanations for inconsistencies and findings. The owner believed that through hard work it had made the project "a model in the Nation" (despite that both HUD and mortgagee considered the project's physical condition to be unsatisfactory), and the owner continually rejected HUD's demands to obtain proper management. Further, the improper disbursements from the operating, security deposit, and replacement reserve accounts demonstrated a glaring disregard by owner and agent of HUD requirements, directives, and agreements.

AUDITEE COMMENTS & OIG EVALUATION

The board president, Victor Camacho, provided a written response (contained in Appendix 2) to our preliminary audit conclusions. We subsequently discussed the audit's conclusions and the president's response on January 26, 1998 with the board president, project administrator Mr. Pabst, and the project's public accountant Dennis Lorette. The former management agent, CPM, did not respond to our requests for comments. The board president told us that CPM advised that it did not intend to respond.

The response from VSC indicates general concurrence with the audit's conclusions except for the matters of the appraisal and payments to Mr. Pabst.

Recovery from CPM

The board plans to seek recovery of project funds misappropriated by CPM and to address management control weaknesses.

Board Oversight

While agreeing that greater board oversight of the project is needed, the board president believed that HUD did not want the board involved in the project's daily operations. As a result, the board was not aware of the former agent's improprieties.

While HUD may not have wanted the board involved in every aspect of the project's daily operations, we note that HUD did not approve CPM agent until CPM and VSC showed that their policy called for the board to approve all expenses over $1,000 in writing, except for normally recurring monthly expenses. In addition, CPM was to provide the board with monthly accounting reports, rent rolls, bank reconciliations, and budgets. Thus, HUD was relying on the board to fulfill its responsibilities and oversee the agent's activities. If the board had been performing this function, then much of the inappropriate activity should have been identified and corrected much earlier. Whether or not the board knew of the inappropriate activity, it was still responsible for their agent's misuse of project funds.

Selection of CPM

The president indicated that HUD is responsible for imposing an inferior agent to manage the project.

HUD wanted the project to obtain professional management because it considered the project to be poorly run without it. While CPM was only one of the available approvable management agents, the board selected CPM because it had acted as the agent on another HUD-insured project, Villa San Pedro, the president had been previously involved with. Still, HUD initially rejected the board's request to hire CPM. HUD wanted an agent that had more experience managing projects similar to VSC. However, due to owner and CPM persistence, HUD eventually approved the agent.

Unsupported CPM Back Fees

In his written response, the president said that the board had not been aware of the back-fees paid to CPM for the period of October 1992 to January 1993. This response is inconsistent with an April 26, 1993 letter from the president to HUD stating that the project would compensate the agent for back-management fees from October 1992 on. The president did not explain this inconsistency when we brought this to his attention.

Appraisal

In the board's written response, the board president stated that the project appraisal was an allowable expense to assess the project's condition. The purpose of the appraisal was to obtain a bank loan to put the project into proper physical condition.

We believe there was no need to obtain a bank loan to fund project repairs. HUD had offered to provide flexible subsidy funds to rehabilitate the project, but the former agent had not completed all actions necessary for the funds' release. In addition, the cost of the appraisal appeared to be excessive since the project had obtained a detailed assessment of the project's physical and financial condition the year before at half the cost.

Further, documents we obtained during the audit only speak of the appraisal in the context of loan refinancing. No copy of the appraisal was available to show that the appraisal's purpose and results were to identify repair and replacement needs. At the meeting, the president told us that the appraisal has never been received. When we advised him that in this case the project received no benefit from the $10,000 appraisal fee and that the appraisal would be useless now, the president said that he intended to obtain a refund.

Project Administrator

The president contends that Mr. Benno Pabst is actually the project's administrator, not a management agent, thus making amounts paid to him allowable.

Nevertheless, HUD Office of Housing has determined that Mr. Pabst was not approvable as management agent and that the costs of additional on-site management were not reasonable.

RECOMMENDATIONS

We recommend that the Office of Housing take the following actions.

A. Assure that acceptable and competent management is in place to run the project.

B. Obtain compensation from the owner and agent as provided under statute and take appropriate administrative action for their misuse of project assets. Determine what portion of the compensation may be turned over to the project.

C. Assure that the physical deficiencies of the project are corrected.

D. Require that misused funds be restored to the VSC replacement reserve.

E. Require the owner to establish proper accounting records and procedures for the retention of records and to submit audited financial statements on a timely basis.

F. Require the owner to judiciously oversee project operations and establish procedures to document the board's involvement.

G. Require the owner to maintain adequate records on the maintenance needs and on the repairs and replacements done for individual housing units and common facilities.

We request that action not be taken on these recommendations until you have first consulted with us.

Finding 2

Other Poor Management Practices Were Noted

In addition to deficient management practices noted in finding 1, we found that procurement practices were inadequate and employee time records appeared to be unreliable. These occurred because of insufficient oversight by the VSC board and the poor management practices by the agent, including violation of the VSC written procedures. These poor practices reduce assurance that the project is operated in a cost effective manner.

The regulatory agreement requires the owner to ensure that project funds are to be used only for reasonable and necessary expenses and repairs. Payments for materials and services are not to exceed amounts ordinarily paid.

The management certification, signed by the management agent, requires the agent to assure that all expenses of the project are reasonable and necessary; exert reasonable efforts to maximize project income; take advantage of all discounts, rebates, and money saving techniques; obtain the necessary verbal or written cost estimates and document the reasons for not accepting other than the lowest bid; and maintain copies of such documentation. The agent also agreed to establish and maintain the project's accounts, books and records in accordance with HUD's administrative requirements, generally accepted accounting principles, and in a condition that will facilitate audit, and to comply with the project's regulatory agreement, HUD handbooks or notices, and HUD requirements.

Time and Attendance Records

Time and attendance records supporting time worked and on leave cannot be relied upon because procedures for the preparation and review of employee time cards were not followed. Employee time cards were supposed to be prepared by the employees, reviewed by the resident manager, and then reviewed by the agent before processing the payroll. However, we found that the resident manager was preparing the time sheets rather than the employees and there was no evidence that the employees had reviewed them. Also, there was no evidence that the agent reviewed the time cards.

Also, a significant number of time cards were unaccounted for. Time cards prepared before April 1996 could not be located by project staff. Time cards after August 1996, when Benno Pabst managed the project, were not maintained in readily-accessible and organized files in the project's administration office files. The resident manager had to search for these documents even though they had only recently been prepared. The poor retention and organization of these files also resulted in the misplacement of time cards for the period between February 6, 1997 and March 5, 1997, which could not be located.

In addition, it appears that not all leave was recorded. For the period reviewed (June 1993 to August 1996), little leave was recorded. The leave that was recorded was largely attributed to only one employee. Also, there was no sick leave recorded between April 1996 and April 1997 on the employee time cards.

As a result of these deficient practices, there is little assurance that employees take no more leave than is due them and that they are properly compensated for leave not taken.

Procurement Practices

The agent did not follow proper procurement procedures. VSC and CPM procurement policy stated that all purchases or contracts over $5,000 required three bids to be obtained in writing. If the lowest bid was not chosen, then the reason was to be given in writing. However, the agent and project staff could not provide such documentation for any purchases and contracts over $5,000 between 1993 and 1996 except for one.

These procurement procedures had been adopted to resolve recommendation 2C contained in a HUD Inspector General audit of VSC issued February 18, 1993. The recommendation called for the project management to establish and implement a procurement policy that requires obtaining necessary services and supplies at a fair and reasonable price. Based on the board's adoption of these procurement procedures on August 16, 1993, HUD closed the recommendation.

The only procurement documentation available at the project was for the 1993 financial audit. Three bids were obtained for the audit. However, the lowest bidder was not selected, and there was no documentation giving the reason for not accepting the lowest bidder.

One of the significant procurements was for the services of a handyman. During the period reviewed (January 1996 to February 1997) the project paid over $13,000 to the handyman. Although no contract was prepared, the handyman was treated as an independent contractor. The project did not obtain competitive bids for his services. The contractor told us that he was a personal friend of the board president. It appears the handyman was chosen based on this relationship.

AUDITEE COMMENTS

Board president Camacho and project administrator Pabst indicated that action was being taken to correct the above situations

RECOMMENDATION

A. We recommend that the Office of Housing require the owner to establish and follow proper procedures for employee time cards and leave records.

Also, we are reopening recommendation 2C of HUD Inspector General audit report 93-SF-212-1006 calling for HUD to ensure that the project's management establishes and implements a proper procurement policy that requires obtaining necessary services and supplies at a fair and reasonable price.

Management Control

Controls Considered

In planning and performing our audit, we considered the management control systems used at Villa San Carlos Garden Apartments to determine our audit procedures and not to provide assurance on management control. Management control is the process effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance for the achievement of objectives for:

- Program operations,
- Validity and reliability of data,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

We determined that the following systems were relevant to our review objectives.

- Expenses and disbursements
- Revenues and receipts

Weak Control Environment

We obtained an understanding of the control structure pertinent to the above systems and determined the risk exposure to design our audit procedures. We did not assess control design or determine whether the policies and procedures had been placed in operation. We did not make a complete assessment because of the weak control environment (in that the systems could not be relied upon) and the limited objectives of the audit. Thus, our conclusions did not rely on the control systems.

A significant weakness exists if management control does not give reasonable assurance that all four control objectives are met. We identified weaknesses concerning uses of project assets as discussed in the report's findings.

Prior Audit Findings

Similar Issues Noted

The HUD Office of the Inspector General previously audited Villa San Carlos Garden Apartments for the period of January 1, 1991 to September 30, 1992 (report number 93-SF-212-1006). The audit report was issued on February 18, 1993. For the period covered by that audit, the project was self-managed so there was no management agent. That audit raised some issues that are similar to those discussed in findings 1 and 2 of the report in-hand.

- Services and materials were not obtained using competitive procurement and bidding procedures.

- The owner's board of directors was not sufficiently involved in the project's financial activities.

Owner Capacity

The prior audit's principal recommendation was to transfer project ownership to a proficient non-profit entity since the owner was considered incapable of operating the project. Part of this conclusion was based on the presumption that an appropriate board of directors did not exist. Subsequently, the owner showed HUD that the board composition was legal. The above issues were resolved upon the hiring of outside management (Creative Property Management) and the establishment of new procurement procedures.

Appendices

Appendix 1

Schedule of Unnecessary, Unreasonable, and Unsupported Amounts

Issue (from finding 1)	Unneces-sary/Unreasonable Amounts	Unsupported Amounts
Management fees	$32,933	$29,747
Payroll	117,187	51,944
Security deposit transfers	13,000	
Workers compensation insurance	23,917	4,867
Miscellaneous disbursements	1,766	11,819
Disbursements by owner	15,000	
Totals	$203,803	$98,377

Unnecessary/unreasonable amounts represent project assets that were not used for necessary or reasonable project operations, thus violating the regulatory agreement.

Unsupported amounts represent project assets where documentation was not available to show that their use conformed with the regulatory agreement. Nonetheless, federal law (12 USC §1715z-4a) states that inadequately documented use of project assets constitutes a violation of the regulatory agreement.

Appendix 3

Distribution

Director, Multifamily Housing Division, California State Office, HUD
Chief, Multifamily Asset Management Branch, California State Office, HUD
Director, Office of Housing, California State Office, HUD
Assistant General Counsel, California State Office, HUD
Secretary's Representative, California State Office, HUD
Director, Accounting Division, California State Office, HUD
Director, Administrative Service Center, Colorado State Office, HUD
Office of Comptroller, Texas State Office, HUD
Deputy Secretary, HUD
Assistant Secretary for Housing, HUD
Assistant Secretary for Congressional and intergovernmental Relations, HUD
Chief of Staff, HUD
Assistant General Counsel, HUD
Deputy Assistant Secretary for Public Affairs, HUD
Counselor to the Secretary, HUD
Senior Advisor to the Secretary for Communications and Policy, HUD
Assistant to the Secretary for Labor Relations, HUD
General Counsel, HUD
Housing-FHA Comptroller, HUD
Director, Participation and Compliance Division, HUD
Director, Housing Finance Analysis Division, HUD
Assistant to the Deputy Secretary for Field Management, HUD
Chief Financial Office, HUD
Deputy Chief Financial Officer for Finance, HUD
Acquisition Librarian, HUD
Committee on Governmental Affairs, U.S. Senate
Government Reform and Oversight Committee, U.S. House of Representatives
Subcommittee on General Oversight and Investigations, U.S. House of Representatives
Director, Housing and Community Development Issue Area, U.S. General Accounting Office
Board President, Villa San Carlos, Inc.
President, Creative Property Management
Dennis L. Lorette & Associates