



Date

February 16, 1996

Audit Case Number

96-PH-214-1013

TO: Charlie Famuliner, Director, Multifamily Division,
Virginia State Office, 3FHM

FROM: Edward F. Momorella, District Inspector General for
Audit, 3AGA

SUBJECT: Great Atlantic Management Company, Inc.
Multifamily Management Agent
Hampton, Virginia

We audited operations at Great Atlantic Management Company, Inc., management agent (agent), to determine whether its management activities and oversight of HUD-insured projects were administered in accordance with applicable HUD regulations and requirements.

The report identifies that project owners incurred ineligible and unsupported expenses, which the agent had an opportunity to prevent, the agent prepared inaccurate reports of excess income for three projects, and a project owner permitted unsanitary housing to exist for two residents.

Report issuance was delayed because of Federal government shut downs.

Within 60 days, please give us, for each recommendation made in the report, 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 considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

If you have any questions, please contact Irving I. Guss, Assistant District Inspector General for Audit, at (215) 656-3401.

Executive Summary

We audited the agent's operations to determine whether its management activities and oversight of HUD-insured projects were administered in accordance with applicable HUD regulations and requirements.

The agent generally managed HUD projects as required. However, deficiencies were identified requiring corrective action in the agent's administrative oversight of projects.

Improper REIT costs paid with project funds

The owner, which has an identity-of-interest with the agent, paid \$92,694 for evaluating the prospects of initiating a Real Estate Investment Trust (REIT) contrary to requirements. The REIT did not become effective and, as a result, funds were expended unnecessarily from operations of two projects.

Oversight of project operations can be improved

Review of agent and owner oversight of project operations identified several areas requiring corrective action. The agent has prepared inaccurate reports of excess income for three projects; the owner of Oak Ridge Gardens has paid a questionable retainer fee totaling \$19,800; and the owner of Oakmont North Apartments I permitted unsanitary housing to exist for two residents. As a result, excess income reports cannot be relied upon, unsupported expenses were paid from project operations, and two units failed housing quality standards (HQS) inspections.

We recommend: (1) ineligible REIT costs are repaid to the projects; (2) the project owner justify the questionable legal fees; and (3) the agent prepare and remit to HUD corrected excess income reports and remit excess income calculated that is due HUD.

We discussed the draft findings with agent representatives during the audit. Where appropriate the agent's comments are summarized in the findings. The draft findings were provided to the agent and their response is included in Appendix B. The agent declined an exit conference.

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Abbreviations

HQS	H o u s i n g Q u a l i t y S t a n d a r d s
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General
REIT	Real Estate Investment Trust

Introduction

Great Atlantic Management Company, Inc., a Virginia Corporation, was founded in 1964 and is wholly owned by Edwin A. Joseph. The agent is headquartered in Hampton, VA with regional offices in Richmond, VA, Charlotte, NC, Fort Lauderdale, FL, and Tampa, FL.

The agent manages 98 projects, 19 are HUD-insured projects, 12 in Virginia and 7 in North Carolina, Georgia, and Florida, totaling 3322 units.

Primary tenant records are maintained at project offices. Financial records are maintained at the agent's office at 2 Eaton Street, Suite 1100, Hampton Virginia.

Audit Objectives

The primary objective of the audit was to determine whether the agent managed HUD-insured projects in accordance with HUD regulations and requirements. Specific objectives were to determine if the agent is: (1) safeguarding project assets, and maintaining reliable accounting data; and efficiencies in operations, and promoting adherence to management's policies primarily relating to receipts and expenditures; (2) complying with the terms and conditions of management agreements, and regulatory agreements, and (3) assuring HUD assistance payments are correct and that the owners are complying with HQS standards.

Audit Scope

We reviewed HUD, agent and project files and interviewed pertinent HUD and agent staff. We inspected 14 Section 8 units at two projects, vacant units at five projects, and observed the physical condition and the common areas of the five projects.

Audit Period

Our audit was performed between July 1995 and December 1995, and covered the activities from January 1994 through June 1995. The audit period was expanded when appropriate.

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

Real Estate Investment Trust Expenses Were Paid From Project Funds

The owner, which has an identity-of-interest with the agent, paid \$92,694 for evaluating the prospects of initiating a Real Estate Investment Trust contrary to requirements. The REIT did not become effective and, as a result, funds were expended unnecessarily from operations of two projects.

Improper REIT costs paid from funds of two projects

The owner improperly paid for evaluating the prospects of initiating a REIT for Crater Square Apartments and Hollymeade Square Apartments which did not become effective. According to the 1994 audited financial statements for both projects, if the REIT did not become effective then the costs were to be allocated to the participating partnerships. However, the owner paid \$40,229 and \$52,465 from Crater Square Apartments and Hollymeade Square Apartments respectively due to the owner's improper use of projects funds.

Crater Square Apartments and Hollymeade Square Apartments had \$129,746 and \$132,525 in surplus cash for 1994 when most of the expenses for the REIT were incurred. The owner could have charged the REIT expenses as an entity expense and offset those expenses from available surplus cash.

The Regulatory Agreement, paragraph 6(b), states that the owner may not obligate project funds to pay for costs other than those reasonable and necessary for the operation and maintenance of the project. Paragraph 6(e), states that the owner may not make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash.

HUD Handbook 4370.2 REV-1, Chapter 4-4 describes project accounts. Account 7000 series provides for mortgagor expenses and states that these expenses may be

Finding 1

charged against project operations only with prior written approval of HUD.

The controller stated that the costs were project costs. We disagree because these expenses were entity expenses and not expenses necessary and reasonable to operate the projects. Further, HUD never granted approval to the owner to charge these costs to the projects.

Auditee Comments

The agent stated that they would reclassify the REIT expense, \$40,229 (Crater Square) and \$52,465 (Hollymeade) from an operating expense to a mortgagor expense and offset the expenses for the REIT from available surplus cash.

OIG Evaluation of Auditee Comments

The agent chose to implement the second option stated in our draft recommendation, and assurance of implementation is necessary.

Recommendation

We recommend:

- 1A. Your staff verify that the REIT expenses have been reclassified from an operating expense to an owner expense and have been offset from available surplus cash for both projects.

Corrective Action is Necessary in Several Areas of Agent and Owner Operations

Review of agent and owner oversight of project operations identified several areas requiring corrective action. The agent has prepared inaccurate reports of excess income for three projects; the owner of Oak Ridge Gardens has paid a questionable retainer fee totaling \$19,800; and the owner of Oakmont North Apartments I permitted unsanitary housing to exist for two residents. As a result excess income reports cannot be relied upon, unsupported expenses were paid from project operations, and two units failed HQS inspections.

A. Inaccurate monthly reports of excess income submitted to HUD

The Regulatory Agreement, paragraph 4(i), states that the owner must prepare a monthly report and pay the difference between the total carrying charges collected and the approved basic carrying charge for all occupied units. HUD Handbook 4350.5, Appendices 12 and 13, provides guidance on preparing the reports. Appendix 13 states that the report shall not include the basic carrying charge for vacant and non-income units and that a zero should be entered as the adjustment for units vacant the entire month.

Excess income reports incorrectly prepared for at least 20 years

The agent has prepared inaccurate reports of excess income for Oak Ridge Garden Apartments, Churchland North Apartments, and Yorktown Square Apartments I. We reviewed five reports of excess income, three for Oak Ridge and one for Churchland and Yorktown, respectively. Our review disclosed that the reports currently being prepared by the agent include a basic carrying charge for vacant and non-revenue units, contrary to HUD requirements. HUD requirements further state that adjustments must be made to basic rents for revenue producing units occupied for less than a full month. However, the agent is making adjustments for units vacant the entire month. The agent has used this method for preparing the reports of excess income for at least 20 years. As a result, the amounts

reported to HUD do not adequately reflect payments due or a balance to be carried forward and cannot be relied upon.

B. Questionable retainer fees paid from project operations

The Regulatory Agreement, paragraph 6(b), states that the owner may not obligate project funds to pay for costs other than those reasonable and necessary for the operation and maintenance of the project.

\$100 monthly retainer fee not justified

Retainer fees totaling \$19,800 have been paid to the Attorney of Fact, Dentron Management Corporation, the General Partner of Oak Ridge Gardens LTD. An internal letter dated February 10, 1978, directs the agent to automatically pay \$100 monthly starting March 1 to the project's attorney and to continue until otherwise directed. According to the agent's controller, the attorney handles all legal issues for the project, however, no support for the services performed have been provided and the \$19,800 is a questionable project expense.

C. Two units failed HQS inspections

The Housing Assistance Payments contract, Section 14a, states that the owner will maintain and operate the project so as to provide decent, safe, and sanitary housing.

The acceptable criteria according to 24 CFR 886.113, paragraph (1) (2) for a unit to be considered sanitary is that the unit and its equipment shall be free of vermin and rodent infestation. Paragraph (f) (2) states that the acceptable criteria for structure and materials is that the roof shall be watertight.

We judgementally selected eight out of fifty five Section 8 units at Oakmont North I Apartments to inspect. Two of the eight failed HQS inspections. The major violations included roach infestation, fire damage and water damage to a living room ceiling. The conditions identified during the inspections of both units were brought to the attention of the agent and your staff. As a result of the cited conditions, tenants were not living in decent, safe and sanitary housing.

A letter received on November 8, 1995, by your office from the agent, stated that both units had been exterminated, the ceiling leak was fixed, and the kitchen cabinet had been repaired.

Auditee Comments

In response to the draft recommendations the agent stated:

- They will prepare and remit to HUD excess income reports according to HUD Handbook 4350.5 for Oak Ridge, Churchland North, and Yorktown.
- The owner of Oak Ridge Gardens has repaid the project for legal fees.
- That documentation was forwarded to HUD regarding the two units at Oakmont North.

OIG Evaluation of Auditee Comments

The agent's response to draft recommendation 2A did not comply with all elements stated. Verification by your staff is necessary to assure legal fees have been repaid and HQS violations have been corrected. Therefore, the recommendations remain as stated.

Recommendations

We recommend:

- 2A. The agent prepare and remit to HUD excess income reports according to HUD Handbook 4350.5 from January 1, 1995 to date for Oak Ridge, Churchland and Yorktown. From January 1995 forward, remit excess income calculated that is due HUD. The same procedure shall be completed for all 236 projects currently managed by the agent.
- 2B. The owner of Oak Ridge Gardens provide supporting documentation for the legal fees paid or repay the project \$19,800 plus additional payments to date.

- 2C. HUD staff verify that corrective action is completed for the two units at Oakmont North I and the units are decent, safe and sanitary.

Internal Controls

In planning and performing our audit, we considered the internal control systems of Great Atlantic Management Company, Inc. to determine our auditing procedures and not to provide assurance on internal control. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

Internal controls assessed

We determined that the following internal control categories were relevant to our objectives:

- Accounting records and reports
- Cash receipts and disbursements
- Excess Income
- Tenant's security deposits
- Section 8 housing assistance payments
- Owner's compliance with HQS standards

Assessment Results

A significant weakness exists if internal 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. Based on our review, we believe the following items are significant weaknesses:

- Cash disbursements
- Excess income
- HQS standards

These weaknesses are detailed in the findings in this report.

Follow Up On Prior Audits

This is the first OIG audit of Great Atlantic Management Company, Inc.

Schedule of Ineligible and Unsupported Costs

<u>Finding Number</u>	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>
1	\$92,694	
2		<u>\$19,800</u>
	<u>\$92,694</u>	<u>\$19,800</u>

1/ Ineligible amounts are clearly not allowed by law, contract, or HUD policies or regulations.

2/ Unsupported amounts are not clearly eligible or ineligible, but warrant being contested for various reasons, such as the lack of satisfactory documentation to support eligibility.

Auditee Comments

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 Multifamily Management Agent
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 96-PH-214-1013
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 February 16, 1996

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