audit report

OFFICE OF INSPECTOR GENERAL

Issue Date	March 19, 1996
Audit Case Number	96-DE-219-1004

TO: Ron Bailey, Director, Office of Housing, 8AH

FROM: W.D. Anderson, District Inspector General for Audit, 8AGA

SUBJECT: California Park East Apartments
Multifamily Mortgage Insured Project
Denver, Colorado
Project Number 101-35274-L8-SR

We have concluded a review of the multifamily insured project known as California Park East Apartments. The project is owned by California Park East Associates; the general partner and mortgagor is King H. Harris. The objectives of our review were to follow up on specific concerns expressed by the Office of Multifamily Housing regarding the management and physical condition of the project; and to assess the owner's compliance with the terms and conditions of the Regulatory Agreement, and with HUD regulations and requirements, regarding the project's books and records.

We found that the Office of Multifamily Housing had effectively monitored and directed the owner's progress toward resolving HUD's concerns with the project. However, the books and records of the project's operations were not maintained in accordance with the terms and conditions of the Regulatory Agreement, or with HUD's regulations and requirements.

Within 60 days, please furnish this office, for each recommendation cited in the report, a status report on: (a) the corrective action taken; (b) the proposed corrective action and the date to be completed; or (c) why action is not considered necessary. Also, please furnish us copies of any correspondence or directive issued because of this review.

We appreciate the courtesies extended by the Office of Multifamily Housing program staff during our review. If you have any questions on this subject, please contact Ernest Kite, Assistant District Inspector General for Audit, at (303) 672-5452.

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Executive Summary

At the request of the Rocky Mountain Office of Multifamily Housing, we have completed a review of California Park East Apartments, a Section 8 Substantial Rehabilitation project insured under Section 221(d)(4). Our objectives were to follow up on specific concerns expressed by the Office of Multifamily Housing regarding the management and physical condition of the project; and to assess the owner's compliance with the terms and conditions of the Regulatory Agreement, and with HUD regulations and requirements. We reviewed the project's books and records for the period from January 1, 1994, through May 31, 1995.

We found that the Office of Multifamily Housing had effectively monitored and directed the owner's progress toward resolving HUD's concerns with the project. As a result, the owner had taken, or was in the process of taking, appropriate action to resolve those issues. However, our review showed that the books and accounts of the project's operations were not maintained in accordance with the Regulatory Agreement, or with HUD regulations and requirements.

The owner had not implemented an adequate system of financial management internal controls and procedures. Specific weaknesses were noted in controls over bank reconciliations, accounts receivable, cash disbursements, cash receipts, and maintenance of the automated accounting system. The lack of adequate controls is illustrated by the fact that over $6,800 of forged and stolen checks that cleared the project's operating account in 1994 were undetected for several months because the project's bank statements were not reconciled. We also found that the management agent improperly allocated supervisory personnel salary costs of $10,780 to the project, and that project funds were diverted to pay for maintenance related expenses of another property.

Bank accounts were not reconciled

The management agent had not reconciled the project's bank statements since late 1994. HUD guidelines specify that bank statements be reconciled promptly to the formal accounting records. We prepared an independent reconciliation of the statements for the 3 months ended January 1995, and found that the operating account balance per the general ledger was overstated by $10,857. This included over $6,800 of forged and stolen checks that cleared the bank during November and December of 1994. These checks were not detected by the management agent until July 1995.

Accounts receivable general ledger balances were unsupported

The management agent did not properly maintain subsidiary ledgers for accounts receivable, and was unable to adequately support the general ledger balances. HUD guidelines specify that accounts receivable balances be supported by subsidiary ledgers. The project's tenant rent and security deposits receivable were tracked on ledger cards; however, the cards were not reconciled to the general ledger receivable accounts.

Additionally, no documentation was available to support non-tenant receivable balances. We also found that tenant accounts receivable were overstated because of incorrect monthly accrual entries, uncollectible receivables were not written off, and advances to the management agent from project funds were not reimbursed on a timely basis.

Cash disbursements were improper

The management agent's procedures for reviewing and approving cash disbursements need improvement. HUD guidelines specify that project funds must be used for the benefit of the project, and that check requests must have supporting documentation. Our testwork showed that cash disbursements were made for non-project expenses, without invoices, or for amounts that differed from the amounts due per the invoices. Additionally, we found that supporting invoices were not marked paid or otherwise canceled, and disbursement checks did not consistently identify all relevant account numbers.

Controls over cash receipts need improvement

The management agent's procedures for recording, depositing, and safeguarding cash receipts were not adequate. HUD guidelines for cash receipts specify that collections be controlled under proper safeguards and promptly deposited, that rent receipts be reconciled to actual collections, and that all cash and checks received be recorded. We found that undeposited cash receipts were not properly safeguarded, cash receipts were not deposited on a timely basis, cash receipt tickets were not reconciled to actual collections, and vending machine cash receipts were not recorded or deposited.

Controls over the accounting system were inadequate

The management agent had limited controls in place to ensure the accuracy and propriety of entries to the automated accounting system. HUD guidelines for insured projects specify that internal control procedures be implemented, with emphasis on maintaining accurate and reliable accounting information. Adequate controls for automated accounting systems typically include passwords that limit access to the system, and regular supervisory review of system generated reports. However, no passwords or other controls were required to access, or post entries to, the project's automated accounting system; and supervisory review of system input and output was inadequate.

Project improperly allocated management agent salary costs

The management agent improperly allocated supervisory personnel salary costs to the project. HUD guidelines specify that salary costs for ensuring that project positions are covered during vacancies, and for hiring and supervising project personnel, must be paid out of management fee funds. The president of the management agent firm was on the project's payroll as a full-time employee for several months through out 1995, including the period from February 25 through June 2. The president reportedly acted as the on-site manager for 3 weeks; and stayed on the payroll an additional 11 weeks to provide training to a new on-site manager. The president was paid $10,780, or $19.25 an hour, for these 14 weeks. This was over and above the $7,300 management agent fee paid for the same timeframe.

Project funds were used for unauthorized purposes

Project funds were diverted to pay for maintenance expenses of an unrelated property. HUD guidelines require that expenses paid out of project funds must be for the operation and maintenance of the project. However, we found instances where the project's labor and materials were used to complete work at a property across the street that was managed by the project owner. Management agent personnel indicated the owner was billed for time and materials spent on the other property. However, the project records showed no evidence of owner reimbursement.

We recommend

We are recommending the Rocky Mountain Office of Housing, Multifamily Management Operations Branch, provide technical assistance and guidance to the owner in establishing the necessary controls over the project's books and accounts. Specific recommendations are provided with the findings.

Auditee Comments

The draft findings were provided to the mortgagor and the management agent on January 12, 1996. An exit conference was held on February 7, 1996. The mortgagor's and management agent's comments have been incorporated in the report as appropriate. Subsequent to the exit conference, the management agent provided information that was not made available during the audit. Based upon this information, we have made appropriate adjustments to the findings. The management agent's final response to the findings is included as Appendix A.

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Introduction

California Park East Apartments, Project Number 101-35274-L8-SR, is a 3-building property consisting of a 53-unit elderly building, a 6-unit multifamily building, and a 10-unit multifamily building. The property's office is located in the elderly building at 2770 California Street, Denver, Colorado. The mortgagor entity is California Park East Associates; the general partner is King H. Harris.

HUD insured the mortgage under Section 221(d)(4) of the National Housing Act. The HUD mortgage documents were executed by King H. Harris as mortgagor. The original mortgage note was in the amount of $2,476,000. The note was current at the time of our review.

On June 13, 1980, the mortgagor executed a Regulatory Agreement with the Colorado Housing and Finance Authority, the holding mortgagee. The agreement limits the use of the project assets, and provides that the books and accounts of the project's operations shall be kept in accordance with HUD requirements.

All of the project units are included under the Section 8 Housing Assistance Payments Contract initially executed on August 28, 1981. The contract is for a maximum term of 20 years. Under the Section 8 program HUD directly subsidizes rents paid by qualified tenants. At the time of our on-site review on July 19, 1995, one unit was vacant.

The project has been managed since April 1988 by CKJ Realty and Management, Inc., located at 1900 Wazee Street, Suite 20, Denver, Colorado. This was the location of the project books and records. Records maintained at the project consisted primarily of tenant files.

In January 1995, the Rocky Mountain HUD office received a congressional request to investigate allegations made by a California Park East tenant. The tenant asserted that there were several maintenance problems at the project, including the elevator, the air circulation system, pest control, and access to the parking lot. On January 25, 1995, HUD program staff conducted an unannounced physical inspection of the project. HUD found numerous irregularities, including a hazardous waste storage area in the basement, and problems with the elevator and the heating and ventilation systems.

On February 10, 1995, representatives of HUD and the Colorado Housing and Finance Authority performed a formal physical inspection of the project. The inspection report reflected an unsatisfactory rating for the overall physical condition of the project, and a below average rating for maintenance policies and procedures. The inspection report indicated that approximately sixty percent of the basement area in the elderly building was being used by the owner to store his personal property. However, all indications of hazardous materials that were present in January had been removed.

On April 3, 1995, representatives from HUD and the Colorado Housing and Finance Authority performed an on-site comprehensive management review of the project. The review report reflected an overall below average rating for management operations.

On June 2, 1995, the Director of the Rocky Mountain Office of Multifamily Housing requested that the Office of Inspector General conduct a review of California Park East's books and records. HUD's specific concerns with the project were as follows:

- Hazardous materials storage on-site without HUD approval.
- Owner's failure to submit an audited financial report for 1994.
- Evidence of deferred maintenance.
- Major increase in the project's security expense.

Our review showed that the Office of Multifamily Housing has effectively monitored the owner's progress toward addressing its concerns. As a result, the owner had taken, or was in the process of taking, appropriate action to address HUD's concerns. Specifically, we found that:

- CMTS Environmental, Inc., a business interest of the owner, was issued a license by the State of Colorado in November 1994 to store radioactive materials in the basement of the project's elderly building. The materials stored were a lead base paint testing gun, and calibration instruments used to test soil compaction. According to a representative from the Colorado Department of Health, the equipment contained shielded radioactive materials that posed no health hazard when stored in accordance with the conditions of the license. The owner removed the radioactive materials from the project prior to the physical inspection in February, and had the license amended to reflect a different storage area.

  In July 1995, representatives from the Colorado Housing and Finance Authority (CHFA) performed a detailed inspection of the areas used by the owner to store his personal property. CHFA advised the owner that five of six areas being used were unsuitable for storage, and the owner subsequently removed most of his personal property from those areas. CHFA and HUD have instructed the owner and management agent to execute a market rate lease for the one acceptable area; the lease must include language prohibiting future storage of hazardous materials.

- The owner submitted the audited financial report for 1994 on June 2, 1995.

- The owner had corrected many of the action items noted in HUD's physical inspection report as of our on-site review on July 19, 1995. Additionally, the owner submitted a Management Improvement and Operations (MIO) Plan that summarized estimated completion dates and costs for the remaining deferred maintenance and capital improvements. HUD has instructed the owner to complete unit-by-unit repair and/or replacement schedules to supplement the Management Improvement and Operations Plan.

- The project's security expense was adequately supported by the terms of the project's security contract, which provided for armed security, 12 hours a day, 7 days a week.

In addition to following-up on HUD's concerns, we also assessed the owner's compliance with the terms and conditions of the Regulatory Agreement, and with HUD's regulations and requirements, regarding the books and accounts of the project. We found several areas that require corrective action.

Objectives and Scope

The objectives of the review were to follow up on the specific concerns expressed by HUD's Office of Multifamily Housing regarding the management and physical condition of the project; and to assess the owner's compliance with the terms and conditions of the Regulatory Agreement, and with other HUD regulations and requirements, regarding the books and accounts of the project. To accomplish these objectives, we reviewed the management and operations of the project and the owner's system of internal controls, and performed various substantive tests.

Our review period covered activities from January 1, 1994, through May 31, 1995.

During the review, we examined accounting records and other documents at the project, the Rocky Mountain Office of Multifamily Housing, the Colorado Housing and Finance Authority, and the management agent. We also conducted interviews with employees of these organizations.

We conducted the audit in accordance with Generally Accepted Government Auditing Standards. Our fieldwork began on July 5, 1995, and was completed on November 1, 1995.

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Financial Management Controls Need to be Strengthened

The owner had not implemented an adequate system of financial management internal controls and procedures. This is illustrated by the fact that over $6,800 of forged and stolen checks that cleared the project's operating account in 1994 were undetected for several months because the project's bank statements were not reconciled on a timely basis. As a result, the project's cash book balances were significantly overstated. In addition, we found the following:

- Accounts receivable balances were unsupported, tenant receivables were overstated, uncollectible receivables were not written off, and advances to the management agent were not reimbursed;

- Cash disbursements of $982.15 were unsupported or inaccurate;

- Cash receipts were not deposited on a timely basis or properly safeguarded, cash receipt tickets were not reconciled to actual collections, and vending receipts were not recorded or deposited; and

- Access controls for the project's automated accounting system were not in place, and supervisory review of system entries was inadequate.

Proper management of the project's books and records is required by the Regulatory Agreement; the Housing Assistance Payments Contract; and HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects. Proper financial management controls help to ensure that project assets are safeguarded; all transactions are executed in accordance with project management and HUD's authorization; and timely, accurate, and complete information is provided for management decision making.

Proper financial management procedures and controls are required

The project owner is obligated to comply with the provisions of the June 13, 1980, Regulatory Agreement between the owner and the Colorado Housing and Finance Authority. The agreement provides that the books and accounts of the project's operations shall be kept in accordance with HUD requirements.

The owner must also comply with the Housing Assistance Payments Contract between the owner and the Colorado Housing and Finance Authority. The contract includes specific provisions for the use of project funds.

HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, details procedures and internal controls to be implemented in connection with an insured project by providing for complete and uniform financial information about the project. The Handbook supplements the requirements of the Regulatory Agreement.

A. BANK ACCOUNTS WERE NOT RECONCILED

Chapter 2 of HUD Handbook 4370.2 REV-1 describes the financial operations and accounting requirements of HUD-insured multifamily projects. Section 2-12, Cash Management Controls, requires that bank statements shall be reconciled promptly to the formal accounting records by persons other than those recording or handling cash, or preparing and signing checks.

Cash balances were not accurate

The management agent had not reconciled the project's bank statements since late 1994. We prepared an independent reconciliation of the project's bank accounts for the 3 months ended January 1995, and found that several general ledger entries needed to be made in order to bring the project's cash accounts into balance for the 3 months reviewed. Below is a summary of the adjustments needed for each account:

ACCOUNT	NET ADJUSTMENT
Operating	($10,856.82)
Security Deposits	$34.49
Payroll	$5,996.30
Reserve for Replacements	$116.39

Forged and stolen checks were not detected

The overstatement in the operating account included over $6,800 of forged and stolen checks that cleared the bank during November and December, 1994. The management agent's offices were burglarized over the week-end of November 26, 1994, and an unknown number of the project's business checks were stolen. The president of the managing firm believes a former employee perpetrated the theft, and that this person also forged checks while still an employee. The president reported the stolen checks to the police and the bank when the theft occurred. However, because the bank statements were not reconciled on a timely basis, the president was unaware until July 1995, that some of the stolen checks, as well as the forged checks, had cleared the bank in 1994.

Regular, documented reconciliation of bank statements to the general ledger cash accounts is a key detective control for ensuring that all cash disbursements from the bank accounts are authorized and supported by appropriate documentation, and that all recorded cash receipts are deposited.

Corrective action had been taken

The management agent contracted with an accountant to prepare the bank reconciliations, and the accountant's work was in process during our review. As of November 3, 1995, the accountant's reconciliations for the project's operating account were current through July 1995. We did not verify the accuracy or completeness of the accountant's reconciliations.

B. ACCOUNTS RECEIVABLE BALANCES WERE UNSUPPORTED

Chapter 4 of HUD Handbook 4370.2 REV-1 lists the prescribed uniform system of accounts used by owners of HUD-insured projects. The use of each account is defined to ensure that project accounting transactions are properly recorded and classified. The definitions for accounts receivable specify that account balances must be supported by subsidiary ledgers, and that receivables be written off when all collection efforts have failed.

Subsidiary ledgers were not properly maintained

The management agent did not properly maintain subsidiary ledgers for accounts receivable, and was unable to adequately support the general ledger balances. The tenant rent and security deposits were tracked on ledger cards, but the cards were not reconciled to the respective receivable accounts. Additionally, no documentation was available to support non-tenant receivable balances.

Tenant-related receivables were overstated

The general ledger tenant accounts receivable balance of $2,499.63 on May 31, 1995, was overstated. The tenant ledger cards reflected no significant outstanding balances, and the project status report dated April 12, 1995, reflected zero delinquencies. The inflated general ledger balance appeared to be the result of incorrect monthly accruals. The management agent records tenant rent receivables based on the rent roll; however, the housing assistance and tenant rent payments reflected on the rent roll were inaccurate for several recently re-certified tenants. The management agent had made no attempt to adjust the incorrect accrual entry to actual receivables each month.

The security deposits receivable general ledger balance of $504 was also overstated. We reviewed entries posted to the account since January 1, 1995, and found that the $504 balance included security deposit refunds of $147 that should have been debited to the security deposit liability account. The management agent did not reconcile security deposits per the tenant ledger cards to the general ledger account.

Uncollectible receivables were not written off

The general ledger reflected two other receivable accounts with balances of $3,291 and $3,285 as of May 31, 1995. The $3,291 balance consisted of payments made in 1992 to two vendors for partially completed work, and the vendors subsequently went out of business without completing the work. Although the management agent had determined in 1993 that there was no remedy to collect the receivables, the accounts were still booked as of May 31, 1995.

Advances to the management agent were not reimbursed

The $3,285 balance consisted of an estimated management fee advanced to the management agent in November 1993, and a warehouse membership paid out of project funds on behalf of the management agent in October 1993. The management agent did not reimburse the project for these advances until June 12, 1995.

Accounts receivable are one indication of how well a project is being managed; therefore, it is important that the receivable balances are accurately stated. Subsidiary ledgers should be maintained for each receivable account carried on the general ledger, and the subsidiary ledgers reconciled to the general ledger balances on a regular basis, preferably by someone who does not post to either ledger. Additionally, it is important that doubtful and uncollectible accounts be recognized and appropriately accounted for.

C. CASH DISBURSEMENTS WERE IMPROPER

The Regulatory Agreement provides that the owner shall not pay out any funds of the project, except for reasonable operating expenses and necessary repairs. Additionally, the Housing Assistance Payments Contract between the owner and the Colorado Housing and Finance Authority requires that project funds must be used for the benefit of the project, to make mortgage payments, to pay operating expenses, and to make required deposits to the replacement reserve.

Chapter 2 of HUD Handbook 4370.2 REV-1 includes the following requirements regarding cash disbursement controls:

- The authorized check signer shall review supporting documentation before signing the check.

- Check requests must have supporting documentation (invoice itemizing amount requested with an authorized signature) in order for approval to be obtained to make the disbursement.

- Invoices and other supporting documentation should be marked "paid" and the check number and date should be posted to the invoice.

- Disbursement checks shall be identified with all relevant account numbers and amounts applicable to each account when one check is for more than one invoice/bill.

Disbursements were unallowable, unsupported, and inaccurate

The management agent's procedures for reviewing and approving cash disbursements need improvement. Vendor invoices were received by the on-site manager. The manager reviewed the invoices, completed check request forms, and forwarded the invoices and request forms to the accounting clerk who prepared the checks. The president reviewed the checks, the check request forms, and the invoices for propriety and accuracy of the disbursement, and signed the checks. Although this procedure provided appropriate separation of duties for processing and approving cash disbursements, it appears the management agent's procedures for ensuring check requests have supporting documentation need to be strengthened.

We tested cash disbursements for the months of September 1994, and March and April 1995, and found disbursements totalling $18,742.26 that were unallowable, unsupported, and inaccurate. Specifically, we found that:

- disbursements were made for operating and personnel expenses applicable to other properties,

- disbursements were made for telephone calls made from a non-project telephone number,

- a disbursement was made for a refrigerator and range that were delivered to a non-project address,

- disbursements were made without invoices or other supporting documents,

- disbursement amounts differed from the amounts due per the invoices or other supporting documents,

- supporting invoices or other documents were not marked paid or otherwise canceled, and

- disbursement checks did not consistently identify all relevant account numbers.

Subsequent to our audit, the management agent provided additional invoices and other documentation that supported $16,643.83 of these expenses. Additionally, the management agent reimbursed the project's operating account for $1,116.28 of disbursements made for operating and personnel expenses applicable to other properties. Appendix B summarizes the remaining $982.15 of unsupported and inaccurate disbursements.

Disbursements made from project funds must be for the benefit of the project, and be supported by invoices or other documentation that have been properly authorized. The management agent's procedures for authorizing, reviewing, and approving the project's cash disbursements should be strengthened to ensure that each expenditure is properly supported, and for a project related expense. Additionally, supporting documentation should be cancelled to prevent resubmission, and disbursement checks identified with relevant account numbers.

D. CONTROLS OVER CASH RECEIPTS NEED IMPROVEMENT

Chapter 2 of HUD Handbook 4370.2 REV-1 includes the following requirements regarding cash receipt controls:

- Whenever possible, all collections shall be promptly deposited on the day received.

- Collections and all other funds held within an office, whether pending regular deposit or in imprest funds, shall be completely controlled under proper safeguards.

- Numbered rent receipts shall be used and reconciled to actual collections.

- An adequate recording system shall be employed to note all cash and checks received and deposited.

- All cash receipts must be deposited in the name of the project in a bank whose deposits are federally insured.

Cash receipts were not deposited on a timely basis, or properly safeguarded

The project's cash receipts were not consistently deposited on a timely basis. The on-site manager said that cash receipts were deposited whenever they exceeded $500. However, our testwork showed that $725.85 of receipts collected through June 29, 1995, and $585.00 of receipts collected on June 30, 1995, were not deposited until July 7, 1995. Additionally, the undeposited cash receipts were kept in an unlocked desk drawer.

Receipt tickets were not reconciled to actual collections

Voided cash receipt tickets were thrown away. Therefore, it was not possible to account for the numerical sequence of tickets issued or to reconcile the tickets to cash collections. Additionally, there was no control to prevent someone from diverting a tenant payment for personal use, and voiding the cash receipt ticket number on the cash receipt journal. The potential for this type of misuse of cash receipts was further increased because access to the unused supply of cash receipt tickets was not restricted.

Vending receipts were not recorded or deposited

Cash collected from a soda machine was not receipted or deposited. One of the soda vending machines at the project was owned by the project owner. Cash proceeds collected from this machine were not recorded on a cash receipt ticket, or deposited to a bank account. Instead, the proceeds were used as a social fund for the tenants. No log was maintained to track the receipt or use of the proceeds.

The lack of controls over the project's cash receipts decreased the project's ability to account for its revenues. Maintaining excessive amounts of cash receipts at the project increased the potential for misuse of project funds. This potential for misuse was further increased because the undeposited receipts were not safeguarded. Additionally, any misuse of cash receipts would not have been detected because the cash receipt tickets were not reconciled to actual collections. The project's cash receipts should be properly safeguarded, and deposited as frequently as possible, preferably daily. The numeric sequence of cash receipt tickets should be accounted for, and the tickets reconciled to the actual collections when the bank deposit is prepared. Additionally, all cash receipts should be recorded and deposited intact, and should not be used for other purposes, such as maintaining an informal petty cash fund.

E. CONTROLS OVER THE ACCOUNTING SYSTEM WERE INADEQUATE

HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, specifies that internal control procedures be implemented, with emphasis on maintaining accurate and reliable accounting information. An automated data processing environment presents special challenges for ensuring adequate internal controls and audit trails because of the limited opportunities for segregation of duties. However, system controls can be established that are designed to prevent, detect, and correct errors that could adversely impact the project's business activities. Examples of system controls for verifying the input, processing, and output of automated accounting systems include:

- Establish password access to the accounting system to ensure only designated employees have access to the system.

- Generate regular reports to ensure that a complete and accurate audit trail exists. The reports should be reviewed by a supervisor on a regular basis.

Access controls were not in place

The management agent had limited controls in place to ensure the accuracy and propriety of entries to the automated accounting system. The system used by the management agent was installed on two stand-alone computers; however, no passwords or other controls were required to access, or post entries to, the system.

The office staff of the agent consisted of the president and an accounting clerk, and the clerk was responsible for preparing and posting all entries to the accounting system. Because there were only two office employees, separation of duties was not practical. However, appropriate compensating controls, such as supervisory review and approval of the clerk's work, were not in place.

Review of entries was inadequate

The president did not review the accounting clerk's work for accuracy and propriety, even though the clerk was responsible for preparing and posting all entries to the automated general ledger and other accounting modules (check register, income register, etc.). In addition to preparing and posting the accounting system entries, the clerk prepared cash disbursements, initiated transfers between bank accounts, prepared payroll, and received and distributed payroll checks. The clerk did not maintain adequate documentation supporting the general ledger entries, and the president did not review and/or approve the entries. Additionally, the president did not review the monthly consolidated general ledger, journal entry, cash receipt, cash disbursement, accounts payable, or other automated reports; nor did the president review the monthly report packages sent to HUD.

System controls for automated accounting systems should be established to prevent, detect, and correct errors that could adversely impact the project's business activities. Passwords or other controls that limit access and posting to the automated accounting system; and regular, documented supervisory review of accounting entries and related reports; should be implemented.

SUMMARY

A sound system of financial management controls is necessary to minimize the potential for misuse of project funds, such as the $6,800 of forged and stolen checks that cleared the project's operating account in 1994. Proper controls will also help to ensure that project assets are safeguarded; all transactions are executed in accordance with project management and HUD's authorization; and timely, accurate, and complete information is provided for management decision making.

Auditee Comments

In general, the project owner and management agent concurred with our finding and recommendations. The management agent's written response, which is included as Appendix A, indicates the agent has initiated, or is willing to initiate, corrective action in establishing the proper financial management controls. The response indicates that documentation justifying the $982.15 of unsupported and inaccurate disbursements was available; however, this documentation was never provided to us.

Recommendations

We recommend the Rocky Mountain Office of Housing, Multifamily Management Operations Branch:

1A Provide the necessary guidance and assistance to the owner in establishing the necessary controls over the project's books and accounts.

1B Require the owner to establish adequate financial management internal controls that encompass the following provisions:

- Prompt reconciliation of bank statements to the general ledger, preferably by someone who does not handle or record cash receipts or prepare or sign checks.
- Supervisory review and approval of bank statement reconciliations.
- Maintenance of subsidiary ledgers for accounts receivable, and regular reconciliation of the subsidiary ledgers to the general ledger, preferably by someone who does not post to the subsidiary ledgers.
- Periodic aging of accounts receivable balances, establishment of reserves for doubtful accounts, and write-off of loss accounts.
- Documented supervisory review of cash disbursements to ensure that payees and check

amounts are supported, and all disbursements are for authorized project expenses.

- Cancellation of invoices and other supporting documentation to prevent resubmission.
- Identification of all relevant accounts on each disbursement.
- Frequent deposit of all cash receipts, including vending receipts.
- Proper safeguarding of undeposited cash receipts and the unused supply of cash receipt tickets.
- Reconciliation of cash receipt tickets to actual collections.
- Passwords or other controls that limit access and posting to the automated accounting system.
- Regular, documented supervisory review of accounting entries and related reports.

1C Review appropriate documentation from the owner to show the corrective actions taken in implementing recommendation 1B above.

1D Require the management agent to submit documentation to HUD, for review and approval as project costs, for the $982.15 in unsupported and inaccurate disbursements detailed in Appendix B.

1E Review the owner's implementation of these recommendations and determine that adequate controls and procedures are established and that they are in conformity with HUD requirements.

1F Require the owner to provide evidence that the bank credited the project's operating account for the stolen and forged checks that were paid.

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Project Improperly Allocated Management Agent Salary Costs

The management agent improperly allocated supervisory personnel salary costs to the project. The president of the management agent firm was on the project's payroll as a full-time employee for several months throughout 1995, including 14 weeks during the first 6 months of the year. The president reportedly acted as the on-site manager for 3 weeks, and stayed on the payroll an additional 11 weeks to provide training to a new on-site manager. The president was paid $10,780, or $19.25/hour, for these 14 weeks. HUD guidelines specify that salary costs for ensuring that project positions are covered during vacancies, and for hiring and supervising project personnel, must be paid out of management fee funds. However, the $10,780 paid to the president was over and above the $7,300 management agent fee paid for the same timeframe.

Supervisory personnel must be paid out of the management fee

On April 1, 1988, the owner and management agent of the property executed a HUD Management Certification statement. Per the terms of the Certification, the owner and the management agent agree to comply with the project's Regulatory Agreement. The agreement provides that the books and accounts of the project's operations shall be kept in accordance with HUD requirements.

Specific accounting requirements and procedures the management agent is to follow are contained in various HUD Handbooks. Handbook 4381.5 REV-2, The Management Agent Handbook, includes the following provision regarding the allocation of management costs:

- Certain management costs may be charged to the project's operating account. However, other management costs may be paid only out of the management fee. Specifically, salary costs for ensuring that project positions are covered during vacancies, and for hiring and supervising project personnel, must be paid out of management fee funds.

President's salary of $10,780 was charged to the project

Payroll expenses for supervisory personnel of the management agent were improperly allocated to the project. We reviewed the project's 1995 payroll journal through the pay period ended June 23, 1995, and found that the president of the management agent received compensation as the project's on-site manager for the period from February 25, 1995, through June 2, 1995. The president was paid $10,780, or $19.25 an hour, for these 14 weeks. This was over and above the $7,300 management agent fee paid for the same timeframe.

The president said he acted as the project's on-site manager during a gap between when he fired one manager and hired another, and that he stayed on the payroll as a full-time employee for about one month after the new on-site manager came on board to provide training.

The president remained on the payroll for several months after an on-site manager was hired

The payroll records show that the president's first paycheck was for the 2 week pay period ended March 10, 1995. The new on-site manager was then hired on March 16, 1995, or about 3 weeks after the president began being paid as the on-site manager. However, instead of staying on the payroll for about one month to train the new manager as the president indicated, he actually stayed on the project's payroll as a full-time employee for 11 more weeks, or through June 2, 1995.

Additionally, documentation provided subsequent to our audit by the management agent showed that the president charged many more hours as the project's on-site manager during the period from late September through mid-December, 1995.

Project management tasks performed by the president were not documented

Allocation of 100% of the president's salary directly to the project account is not an acceptable use of project resources. Subsequent to the audit, the management agent provided timesheets supporting the hours spent by the president at the project. However, no documentation was provided regarding whether the duties performed by the president included front-line activities of the project.

Additionally, the hourly rate paid to the president does not appear to be reasonable. A reasonable rate includes the hourly salary for the position and an allocation for overhead expenses, and should not exceed the amount that would be paid to an on-site staff member with similar experience. The president was paid $19.25 an hour, while the on-site manager hired in March was paid $7.75 an hour.

Auditee Comments

The management agent disagreed with our finding and recommendations. The agent's written response, which is included as Appendix A, indicates that the president carried out the everyday supervisory role of the on-site manager while searching for replacement managers; and while training, monitoring, and supervising new on-site managers. However, the response goes on to indicate that the president will no longer collect a salary for on-site supervision, and will cooperate with HUD in determining whether the salary already paid is an allowable project expense.

Recommendations

We recommend the Rocky Mountain Office of Housing, Multifamily Management Operations Branch:

2A Determine the total amount of supervisory personnel salary costs that were allocated by the management agent to the project during 1995 and year-to-date 1996.

2B Determine how much, if any, of the supervisory personnel salary costs allocated to the project, are an allowable project expense under HUD's requirements.

2C Require that the owner direct the management agent to reimburse the project for unallowable supervisory personnel salary costs that were allocated to the project.

2D Require the owner to provide appropriate documentation to show that the management agent reimbursed the project.

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Project Funds Were Used for Unauthorized Purposes

Project funds were diverted to pay for maintenance expenses of an unrelated property. HUD guidelines require that expenses paid out of project funds must be for the operation and maintenance of the project. However, we found instances where the project's labor and materials were used to complete work at a property across the street that was managed by the project owner. Management agent personnel indicated the owner was billed for time and materials spent on the other property. However, the project records showed no evidence of owner reimbursement.

Expenses must be project-related

The project owner is obligated to comply with the provisions of the June 13, 1980, Regulatory Agreement between the owner and the Colorado Housing and Finance Authority. The agreement provides that the books and accounts of the project's operations shall be kept in accordance with HUD requirements.

The owner must also comply with the Housing Assistance Payments Contract between the owner and the Colorado Housing and Finance Authority. The contract requires that project funds must be used for the benefit of the project.

Specific accounting requirements and procedures the project owner is to follow are contained in various HUD Handbooks. Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, provides that disbursements of project funds should only be used to pay reasonable expenses necessary for the operation and maintenance of the project, distributions of surplus cash, or to repay owner advances.

Project funds were used to pay expenses of another property

Project funds were diverted to pay for maintenance related expenses of another property. The address of the project's elderly building is 2770 California; the two multifamily buildings are located at 621-631 28th Street, and 820-836 28th Street. However, our review of the project's maintenance records for March 1995 showed that five work orders were issued on March 24 for unit addresses in the 700 block of 28th Street. These unit numbers did not correspond to the project's unit addresses. We found that these units were located in a building across the street from the project that was managed by the project owner.

According to the management agent's staff, the on-site manager of the owner's other building had sometimes requested that the project's maintenance staff perform work at the other building. The project's on-site manager provided the labor and materials needed to complete work at the other building when the project's maintenance schedule allowed it.

The on-site manager indicated that he billed the owner for labor and material expenses incurred by the project for work performed at the other building. However, we reviewed activity posted to the project's general ledger since January 1994, and found no evidence that the owner reimbursed the project for these costs.

Subsequent to our audit, the management agent billed the owner for labor and materials expenses incurred on three work orders for the other building. However, none of the work orders billed by the management agent corresponded to the work orders we found that were issued on March 24.

Auditee Comments

The project owner and management agent concurred with our findings and recommendations. The management agent's response, which is included as Appendix A, indicates that invoices were presented to the owner for work performed at the other building, and that the practice of issuing work orders at the other building will cease. Also, the management agent verbally agreed to take action to ensure all additional work orders for the other building are identified and invoiced.

Recommendations

We recommend the Rocky Mountain Office of Housing, Multifamily Management Operations Branch:

3A Require the owner and management agent to discontinue the practice of using the project's labor and materials to perform maintenance work at the owner's other property.

3B Identify all work orders issued during 1995 and year-to-date 1996 for unit addresses in the 700 block of 28th Street.

3C Require the management agent to invoice the owner, and the owner to reimburse the project's operating account, for labor and materials expended on work performed at the owner's other property.

3D Require the owner and/or management agent to provide appropriate documentation to show the corrective actions taken by the owner.

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Internal Controls

We selected and tested transactions and records to determine whether the owner complied with regulations that prescribe requirements for internal controls over the management and maintenance of the books and records of multifamily insured and subsidized projects. For the items tested, we found noncompliance with these regulations as described in the Executive Summary and Findings.

In planning and performing our review, we considered the internal controls in place over the project's activities in order to determine our auditing procedures and not to provide assurance on internal controls.

Internal controls consist of the plan of organization and methods and procedures adopted by management to ensure 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.

Internal Controls Assessed

We determined that the following controls were relevant to the audit objectives and each was assessed during our review:

- Controls that ensure project assets are safeguarded.
- Controls that ensure funds are properly expended.
- Controls that ensure reliable accounting data.
- Controls that ensure compliance with the terms and conditions of the Regulatory Agreement and with HUD regulations and requirements.

A significant weakness exists if internal controls do not give reasonable assurance that resources are used consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained and maintained, and fairly disclosed in the financial statements and reports.

Assessment Procedures

The following audit procedures were used to evaluate internal controls:

- Interviews with staff knowledgeable of the day-to-day application of controls in each of the control systems identified above.

- Review and tests of the project's operating policies and procedures.

- Review of the project's accounting and administrative records.

- Tests of the execution of a sample of transactions related to each of the control systems identified above.

Significant Weaknesses

We identified significant internal control weaknesses in the following areas:

- The owner did not have safeguards in place to protect project assets against waste, loss, and misuse.

- The owner did not have adequate controls to ensure the propriety of cash disbursements.

- The owner did not have adequate controls to ensure the reliability of accounting data.

- The owner did not comply with the terms and conditions of the Regulatory Agreement regarding the books and records of the project's operations.

Follow Up On Prior Audits

This was the Office of Inspector General's first audit of California Park East Apartments. The project is also subject to annual financial audit by an Independent Public Accountant, as well as periodic reviews by HUD. The results and follow up of each of the most recent reviews follows.

Annual Financial Audits

Results

The 1994 financial audit was prepared by Jackson & Goldstine. The report noted no instances of noncompliance with HUD program requirements. Additionally, no matters involving the project's internal control structure and its operations were considered to be material weaknesses.

HUD Reviews

Results

The most recent HUD reviews of the project were conducted in February and April 1995. The inspection report reflected an unsatisfactory rating for the overall physical condition of the property, and a below average rating for maintenance policies and procedures. The management review report reflected an overall below average rating for management operations.

HUD transmitted the results of the reviews to the owner in May 1995 and has conducted periodic follow up reviews since then to monitor and assess the owner's progress in taking corrective action.

Follow Up

We found that HUD has effectively monitored the owner's progress toward addressing HUD's concerns with the physical condition and management of the project. As a result, the owner had taken, or was in the process of taking, appropriate action to resolve the concerns.

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Auditee Comments

Schedule of Unsupported and Inaccurate Disbursements

The following is a listing of cash disbursements reviewed for the months of September 1994, and March and April, 1995, that did not have sufficient documentation to support the disbursement, or the disbursement amount exceeded the invoiced amount.

DATE PAID	VENDOR	CHECK	AMOUNT	DESCRIPTION OF PROBLEM
03/20/95	Mile High Maintenance	1361	$39.07	Invoice for $87.30 paid twice; $48.23 not paid
03/20/95	AT&T	1365	$126.89	Partial invoice; can't tie to CPE phone numbers
03/20/95	U.S. West	1366	$183.11	Partial invoice; can't tie to CPE phone numbers
04/14/95	Public Service	1402	$633.08	Invoice for $676.83 paid twice; $43.75 not paid
	TOTAL		$982.15	

None of the invoices or other supporting documentation tested were marked "paid" or otherwise canceled to prevent resubmission.

Additionally, 37 of 106 disbursement checks tested were not identified with all relevant account numbers.

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