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May 31, 2002

2002-FW-0801

MEMORANDUM FOR: Raynold Richardson
Director, Houston Multifamily Program Center, 6EHM

/SIGNED/

FROM: D. Michael Beard
Regional Inspector General for Audit, 6AGA

SUBJECT: Referral of Annual Audited Financial Statements
Completed by George Baugh III & Company

At your request, we performed a limited review concerning unreported noncompliance issues in annual audited financial statements completed by George Baugh III & Co. Our limited review showed only one of the allegations was valid: the firm did not disclose Sunlight Manor's late residual receipts deposit in the project's 2000 audited financial statements. Since our review of the allegations did not disclose significant instances of noncompliance by George Baugh III & Co., we will not perform a quality control review of the firm at this time. However, HUD should require the firm to correct the financial statements of the Sunlight Manor.

Background

Your office alleged that the Independent Public Accountant (IPA), George Baugh III & Co., did not report noncompliance issues for four properties: Prince Hall Village¹; Sunlight Manor Apartments;² Virginia Manor Apartments;³ and Sunset Hills Apartments.⁴ Specifically, your office alleged that the IPA failed to report that the:

- owner did not establish or make timely deposits to a residual receipts account (Prince Hall, Sunlight Manor);
- management agent overpaid itself (Prince Hall, Sunlight Manor, Virginia Manor);
- management agent improperly received fees to do bookkeeping/ accounting, and prepare Forms 1099 and W-2 for the projects (Prince Hall, Sunlight Manor, Virginia Manor);
- tenant accounts receivable was not accurate (Sunlight Manor); and
- tenant security deposit fund was not transferred to the new management agent (Sunset Hills).

¹ FHA # 114-35005

² FHA # 114-35085

³ FHA # 114-44002

⁴ FHA # 114-35050

In addition, your office alleged that the Sunset Hills financial statements did not reflect the status of flexible subsidy funds and that the IPA lacked independence because he also completed a certification for flexible subsidy funds for Prince Hall Village.

Methodology

Our review consisted of reviewing the various project files and interviewing your staff. We limited the review to 3 years, from 1998 through 2000, because HUD only requires independent public accountants to retain working papers for 3 years.⁵

Findings

All of the allegations were invalid and/or unsupported, except for one. The allegation that George Baugh III & Co. did not report Sunlight Manor's untimely residual receipts deposit in the 2000 audited financial statements is valid. However, George Baugh III & Co. was not responsible for reporting the late residual receipts deposit for Prince Hall since the firm did not perform the 2000 audit. In addition, the firm properly disclosed in its financial statements any overpayments of management fees for the various projects. The other allegations were either not specific or were refuted by information in the project files or HUD regulations. For example, the Sunset Hills project files contained a letter from the old management agent stating the tenant security deposit funds were transferred. Your staff generally agreed with our conclusions. Yet, they still contended that it was improper for a management agent to receive fees to perform bookkeeping and accounting services. Your staff stated that having the management agent perform bookkeeping duties was an internal control violation prohibited by HUD Handbook 4370.1. In our opinion, that interpretation is incorrect. The cited regulations merely states, "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." Thus, the regulations only require a segregation of duties between individuals performing certain duties and not firms. In addition, the project files showed that HUD, on two occasions, approved special fees to the management agent for bookkeeping and accounting.

Since only one allegation was supported, we do not believe a quality control review of this CPA is needed at this time. However, HUD should require George Baugh III & Co. to revise its 2000 Sunlight Manor audited financial statements to include a finding that the owner did not deposit residual receipts in a timely manner.

⁵ Section 1-6 of HUD OIG Handbook 2000.04 REV-2, Independent Auditors, Consolidated Audit Guide for Audits of HUD Programs.

Recommendation:

1. HUD Houston Multifamily should require George Baugh III & Co. to correct the Fiscal Year 2000 financial statements for Sunlight Manor. Sunlight Manor's financial statements should disclose that the owner did not deposit residual receipts in a timely manner.

DISTRIBUTION

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