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District Inspector General for Audit

March 26, 2002

Audit Memorandum
No. 2002-PH-1802

MEMORANDUM FOR: Charlie Famuliner, Director, Multi-family Program
Center, 3FHMLP

Daniel G. Temme

FROM: Daniel G. Temme, District Inspector General for Audit,
Mid-Atlantic, 3AGA

SUBJECT: D.B. Frye and Associates
Management Agent Activities
Norfolk, Virginia

We completed a limited review of project operations and management agent activities of D.B. Frye and Associates, an owner and identity-of-interest management agent. The review was initiated in conjunction with an investigation conducted by the Office of Inspector General for Investigations, Mid-Atlantic of alleged financial mismanagement at the Stuart Gardens I and II projects. The criminal investigation showed employees at both Stuart Gardens projects circumvented financial and procurement controls and embezzled over \$891,000 in fraudulent construction, renovation, and rent receipt schemes over several years.

We reviewed the Owner/Agent's operations at four multi-family projects (Stuart Gardens I and II, Hilltop North, and Southgate Court) within the jurisdiction of the Virginia State HUD Office to determine whether the Owner/Agent operated the projects in accordance with Regulatory and Management Agreements and in compliance with HUD requirements.

We found the Owner/Agent did not maintain adequate accountability over project financial operations in accordance with its regulatory and management agreements with HUD. In total, the Owner/Agent could not provide adequate documentation to support \$1.1 of the \$6.65 million expenditures we reviewed for the four projects. Details of our review can be found under the "Results Of Our Review" section of this memorandum.

BACKGROUND

D.B. Frye and Associates (the Agent), an identity-of-interest company, is owned by its sole stockholder, D.B. Frye, Jr. As a principal in several limited partnerships, D.B. Frye, Jr. also owned the projects that the Agent Company managed. D.B. Frye, Jr. (the Owner) and the Agent owned/managed nine HUD insured and/or Section 8 assisted projects located in Virginia, Georgia, and North and South Carolina. D.B. Frye, Jr. also owned/managed an additional 12 conventionally financed, non-subsidized projects. The HUD financed/assisted projects are described as follows:

Project Name	Location	HUD Insured	Total Units	Section 8 Units	Project Status*
Stuart Gardens I	Newport News, VA	No	252	250	NT
Stuart Gardens II	Newport News, VA	No	239	239	NT
Southgate Court	Richmond, VA	Yes	112	112	PT
Hilltop North	Richmond, VA	Yes	159	0	T
Victory Gardens	Savannah, GA	Yes	192	192	NT
Forest Grove	Greensboro, NC	Yes	278	0	NT
Sterling Oaks	Norfolk, VA	Yes	160	0	NT
Sumter Villas	Sumter, SC	Yes	112	112	NT
Hilton Head Gardens	Hilton Head, SC	Yes	112	112	PT
Totals			1,616	1,017	

* Project financial and physical status as established in HUD's Real Estate Management System (NT = Not troubled; PT = Potentially troubled; T = Troubled)

Our review focused on operations at the Stuart Gardens I and II, Southgate Court, and Hilltop North projects. The Owner/Agent currently manages Stuart Gardens I and II. Although HUD did not insure these projects, they receive Section 8 assistance that is administered by the Virginia Housing Development Authority (VHDA). Hilltop North, a fully insured HUD project, and Southgate Court, a co-insured HUD project, receive Section 8 assistance that is administered by the Richmond Redevelopment Housing Authority (RRHA). The Owner/Agent managed Hilltop North and Southgate Court until August 1999, transferring management duties to Artcraft Management, Inc. (Artcraft) at that time. Southgate Court was eventually sold to Artcraft in 2001. Artcraft currently manages Hilltop North and Southgate Apartments.

Identity-of-interest parties are those that share an ownership interest. Although HUD guidelines allow management agents to conduct business with identity-of-interest companies, special care is required to ensure costs are competitive and reasonable. The Owner/Agent has an identity-of-interest relationship with several companies. During the audit period, six of these companies (Tidewater Grounds Division, Frye Properties–Grounds, Frye Properties–Construction, Richmond Investment Properties, Hilltop North Associates, and Freemason Builders) conducted business with the projects or were issued payments from project funds at the four projects we reviewed. D.B. Frye, Jr. had principal limited partnership and ownership interests in these six companies.

CRITERIA

The Regulatory Agreement between Stuart Gardens I and II and VHDA provides that mortgagors shall not, without the prior written approval of the Authority, assign, transfer, dispose of, or encumber any personal property of the development, including rents, or pay out any funds of the development, except for reasonable operating expenses and necessary repairs.

The Housing Management Agreements between the Agent and the Owner for Stuart Gardens I and II states the Owner and Agent shall comply with all applicable provisions of HUD handbooks, regardless of whether specific reference is made thereto in any particular provisions of this Agreement. In addition, the Agreements state that all bookkeeping, clerical, and other management and overhead expenses of the Agent's home office (including, but not limited to, costs of office supplies and equipment, data processing services, postage, transportation for managerial personnel, and telephone services) will be borne by the Agent out of its own funds and will not be treated as a Project expense.

The Regulatory Agreements between Hilltop North and Southgate Court and HUD mandates that owner will:

- Assure that all project expenses are reasonable in amount and necessary to the operation of the project.
- Comply with the HUD Secretary's administrative requirements regarding payment and reasonableness of management fees and allocation of management costs between the management fee and the project account.
- Not obligate the project to pay for costs other than those reasonable and necessary to the operation and maintenance of the project.
- Purchase goods and services from identity-of-interest individuals or companies only if the charges levied by those individuals or companies are not in excess of the costs that would be incurred in making arms-length purchases on the open market...
- Obtain contracts, materials, supplies and service on terms most advantageous to the project and at costs not in excess of amounts normally paid...
- Solicit oral or written cost estimates as necessary to assure compliance with the provisions of this paragraph and document the reasons for selecting other than the lowest estimate. Maintain copies of such documentation available for inspection.

HUD handbook 4370.2 Rev-1, Financial Operations and Accounting Procedures for Insured Projects provides that all disbursements from the regular operating account (including checks, wire transfers and computer generated documents) must be supported by approved invoices/bills or other supporting documentation.

OBJECTIVES, SCOPE AND METHODOLOGY

The primary objective of our review was to determine whether the Owner/Agent complied with HUD regulations and requirements pertaining to the use of project funds. To accomplish our objective we:

- Interviewed HUD Multi-family, Owner/Agent, VHDA, RRHA, and project staff; and,
- Reviewed payments and other relevant financial transactions and information from project operating accounts.

We reviewed all project expenditures for four projects (Stuart Gardens I and II, Southgate Court, and Hilltop North) in Virginia for the period January 1, 1998 through December 31, 2000¹. Altogether, these project expenditures totaled \$6.65 million. The review was conducted at various times from March 2001 to September 2001. The review was conducted in accordance with generally accepted government auditing standards.

RESULTS OF OUR REVIEW

We found the Owner/Agent did not maintain adequate accountability over project financial operations in accordance with its regulatory and management agreements with HUD. The Owner/Agent used project funds to pay various expenditures that were not adequately supported as necessary and reasonable. Altogether, \$1.1 of the \$6.65 million expenditures for the four projects we reviewed lacked adequate documentation to support those expenditures (see Attachment B). Specifically, unsubstantiated expenditures were associated with:

- Services provided by identity-of-interest companies and employees
- Management fees
- Miscellaneous goods and services
- Owner/Agent overhead costs
- Accounting and payroll expenses
- Computer fees
- Payments to the Owner/Agent

This occurred because of the Owner/Agent's apparent disregard for adhering to HUD requirements related to the use of project funds. As a result, we have no assurance that these project expenditures were necessary and reasonable for project operations, and significant risk may be associated with the financial aspects of these projects, as well as others under management of the owner/agent throughout the Southern United States, in protecting HUD's

¹ We reviewed payments processed during the period January 1, 1998 to December 31, 2000 at the Stuart Gardens I and II projects. Because of the change in management agent companies in August 1999, we reviewed payments processed from January 1, 1998 to August 31, 1999 at the Hilltop North and Southgate projects.

financial interests and the tenants' interest. Further, since several of the projects have been identified as troubled and partially troubled in HUD's Real Estate Management System, HUD should increase its monitoring efforts over all the Owner/Agent's projects to ensure HUD and the tenants' interests are adequately protected. Unsupported expenditures by category and project are summarized as follows:

Unsupported Cost Category		Stuart Gardens I	Stuart Gardens II	Hilltop North	Southgate Court	Totals
Payments to identity-of-interest firms and employees	a:	64	47	37	16	164
	b:	\$257,030	\$149,454	\$34,783	\$28,993	\$470,260
Management fees	a:	4	0	18	17	39
	b:	29,342		\$90,846	\$101,240	\$221,428
Miscellaneous payments for goods and services	a:	29	16	68	36	149
	b:	\$17,558	\$26,826	\$104,600	\$43,024	\$192,008
Agent overhead costs	a:	55	28	24	19	126
	b:	\$50,245	\$26,847	\$35,779	\$6,802	\$119,673
Accounting and payroll expenses	a:	0	0	1	10	11
	b:			\$9,540	\$45,774	\$55,314
Leased computer equipment	a:	35	28	15	13	91
	b:	\$8,645	\$6,664	\$2,850	\$1,875	\$20,034
Payments to the Owner/Agent	a:	0	0	0	5	5
	b:				\$19,955	\$19,955
Totals	a:	187	119	163	116	585
	b:	\$362,820	\$ 209,791	\$278,398	\$ 247,663	\$1,098,672

a: = number of payments; b: = dollar value

A detailed discussion of each unsupported cost category is provided in the following paragraphs:

Payments to Identity-of-Interest Companies and Project Employees

The Owner/Agent made at least 164 unsupported payments totaling \$470,260 during the audit period for groundskeeping, repairs and maintenance, rent, computer services, and undeterminable reasons to identity-of-interest companies owned by the Owner/Agent and to project employees. Because contracts, invoices, and bids were either not available or insufficiently detailed, we could not determine if the costs were reasonable and necessary to project operations.

- Tidewater Grounds Division and Frye Properties–Grounds, companies owned by the Owner/Agent, were paid 105 payments totaling \$293,457 for groundskeeping services. Groundskeeping payments are detailed by project as follows:

Project	Payments	Amount
Stuart Gardens I	37	\$130,077
Stuart Gardens II	34	124,304
Hilltop North	19	22,583
Southgate Court	15	16,493
Totals	105	\$293,457

Although a contract was awarded in 1999, 2000, and 2001 for the Stuart Gardens I and II projects, the reasonableness of the costs could not be validated since other vendors generally were not solicited. We evaluated the cost of the contract over a three-year period and determined not only was the reasonableness of the initial award questionable, significant cost increases may have been unreasonable. For example, in 1999 the contract was awarded for \$85,000. In 2001, the same contract was awarded for \$135,000, a 59 percent increase. Responsible project employees could not provide contracts and bids for the groundskeeping services performed at the Hilltop and Southgate projects. Additionally, employees could not provide most supporting invoices for groundskeeping payments made to both identity-of-interest companies. When provided, invoices were not sufficiently detailed to properly support the payment.

- Frye Properties – Construction and Freemason Builders, companies owned in part by the Owner/Agent, were paid eight payments totaling \$72,836 for repair and maintenance services at the Stuart Gardens I project. Contracts were not available and invoices did not contain sufficient details to fully identify the nature and extent of the services provided. Bids showing other vendors had been solicited were not available.
- The maintenance supervisor for Stuart Gardens I and II was issued 30 payments from project accounts totaling \$78,400 for plaster ceiling repairs. Contracts and invoices detailing the specific work requirements were generally not available, and when provided, did not contain sufficient information to fully support the costs as a reasonable project expense. In addition, documentation showing that other vendors were solicited was not available.
- The Agent used the Hilltop North project account to pay themselves (project ownership entity owned by the Owner/Agent) 18 payments totaling \$12,200. The funds were used to pay monthly rent for a vacant unit used as project office space. According to HUD multi-family asset management personnel, charging the

project rent for office space is a highly questionable practice and cannot be considered a normal project operating expense.

- A Stuart Gardens I and II employee received two payments totaling \$868 for computer support services. Details surrounding the nature and extent of the services provided were not available.
- The Agent used Southgate Court project funds to pay one \$12,500 payment to Richmond Investment Properties, Inc., the project's ownership entity. The company was owned in part by the Owner/Agent. We could not substantiate the basis for this expense since responsible personnel could not provide an invoice or supporting documentation detailing the circumstances surrounding the expense.

Because these costs were paid to identity-of-interest companies and project employees, extra controls are needed to ensure transactions are at arms length and reasonably priced. To do otherwise could unduly enrich ownership principals and project employees, and subject the project to adverse financial risk.

Management Fees

Management agent fee payment provisions are established in the Housing Management Agreement and generally are computed as either a fixed-fee or a percentage of rent receipts. As such, management agent fees would not vary significantly from month to month. However, supporting documentation for 39 unusual management agent fee payments totaling \$221,428 processed at the Hilltop North and Southgate Court projects was not available to show how the payments were computed. Our review of the projects' disbursement records showed that payments were made out-of-cycle and accruals were frequently used in an apparent attempt to reconcile the management fee due to the Owner/Agent. While our review showed the Agent did not receive management fees in excess of entitlements, invoices and computational details were not available to support the basis for the questioned management fees.

Miscellaneous Vendor Payments

The Owner/Agent made 149 unsupported payments totaling \$192,008 to a variety of vendors for miscellaneous goods and services at all four projects reviewed. Because invoices were either not available or insufficiently detailed to identify the expense, we could not determine, in most cases, what was purchased. Purchases we could identify included things such as major appliances, plumbing and routine maintenance supplies, and repair and maintenance services.

Management Agent Overhead Costs

The Owner/Agent could not adequately support 126 payments for overhead expenses valued at \$119,673 paid in part by all four projects reviewed. Costs included those

associated with copy machines, faxing, postal fees, computer technical support, bank charges, credit fees, and other miscellaneous allocated Management Agent expenses. The Owner/Agent and project employees could not provide sufficient documentation to show the specific nature of these costs. These Management Agent expenses could not be adequately supported as necessary project costs. HUD guidelines prohibit project funds from being used to pay Management Agent overhead costs and Management Agreements specifically state that these expenses are to be borne by the Management Agent out of its own funds.

Accounting and Payroll Expenses

According to the Management Agreements for Southgate Courts and Hilltop North, the Management Agent is authorized to charge the project \$420 and \$596, respectively, for monthly accounting fees or \$5,040 and \$7,152 annually. However, during 1998 and 1999, the Owner/Agent charged the Southgate Court project \$15,540 in out-of-cycle billings. Southgate paid the \$420 monthly accounting fee in May and June 1998, January, February, April, June, and August 1999 for a total of \$2,940. The Owner/Agent also processed and collected two additional payments totally \$12,600 for accrued accounting fees. One payment totaling \$9,540 was made for accrued accounting fees at Hilltop North by the Owner/Agent during 1998. Management Agent personnel could not explain the basis for the payments and could not provide supporting documentation identifying the nature and relevant periods of the accrued accounting fee. Also, our review of Southgate Court's financial records showed that the Owner/Agent processed one payment amounting to \$30,234 for unsupported payroll expenses. Documentation was not available to identify the basis for the expense amount.

Leased Computer Equipment

The Owner/Agent made 91 unsupported payments totaling \$20,034 from all four project operating accounts to pay fees associated with leased computer equipment. The Owner/Agent generally made these payments in association with the monthly management fee, combining the computer equipment fee with his management fee payment on one check. However, we could not determine the types and quantities of leased computer equipment since the Owner/Agent and Project employees could not provide lease agreements or other documentation to support the payments. Additionally, relevant project Management Certifications did not authorize the Owner/Agent to pay himself a leased computer equipment fee. Because our on-site inspections did not disclose any significant computer equipment in project offices, it is likely that these fees are allocated expenses from Owner/Agent and other identity-of-interest companies.

Unsupported Payments Made to the Owner/Agent

The Owner/Agent used Southgate Court project funds to make payments to the Management Agent operating account without adequately documenting the basis for the

transactions and supporting the payments as necessary for project operations. We identified five of these payments valued at \$19,955. Details are as follows:

- The Owner/Agent used Southgate project funds to process one \$18,000 check made payable to the Owner/Agent. We were told the transaction was used to reimburse Agent funds that were advanced to the project. However, an invoice or supporting document describing the details of the advance were not available.
- The Southgate project account was used to make four payments totaling \$1,955 to transfer project funds to the Owner/Agent's account. We could not determine the basis for these payments since invoices and supporting documentation were not available.

We received a written response from D.B. Frye and Associates and discussed the results of our review with responsible officials from D.B. Frye and Associates and the Richmond Multi-Family Program Center on March 6, 2002. The auditee's full response is included under Attachment A. Based on responses to the draft report we made appropriate changes to our recommendations.

Auditee Comments

D.B. Frye and Associates officials stated that they believed they had successfully responded to most of the auditor's inquiries during the audit. However, they also stated that some aspects of the documentation were complicated by virtue of the characteristics and situations unique to the properties reviewed. Therefore, they agreed to provide additional documentation they stated would support the 585 payments valued at \$1,098,672 identified during the audit as unsupported project costs by April 1, 2002. They stated further that they were confident that this additional documentation would successfully respond to most, if not all, of the issues in this report.

D.B. Frye officials also stated that clearly stated procedures are in place to ensure payments from project accounts are made only for expenses to project operations, and that such transactions are handled in strict accordance with applicable HUD requirements. They stated that these procedures are outlined in an excerpt from the Frye Properties Operating Handbook. Officials verbally acknowledged, however, that these procedures were not fully implemented as evidenced by our audit findings and recent criminal investigations showing that employees circumvented financial and procurement controls to embezzle over \$891,000 over several years. In light of the seriousness of these matters officials also agreed to emphasize and fully implement the procedures.

Richmond Multi-Family Program Center Comments

Richmond Multi-Family Program Center officials agreed to review the adequacy of the documentation provided by D.B. Frye and Associates, and to require reimbursement if the costs remained unsupported. They also agreed to perform the coordination necessary to determine if

additional monitoring efforts of D.B. Frye and Associates management agent operations were warranted at projects located outside of the State of Virginia. They further agreed to take any necessary administrative actions against D.B. Frye and Associates.

OIG Evaluation of Auditee Comments

We consider the agreed to actions responsive to our finding. We are encouraged that D.B. Frye officials feel confident that they will be able to provide additional documentation to support all of the 585 payments valued at \$1,098,672 identified during the audit as unsupported project costs. We are also encouraged that D.B. Frye officials acknowledged that procedures contained in their Operating Handbook were not emphasized or fully implemented. In our opinion this lack of emphasis is clearly shown by our audit findings and more importantly by recent criminal investigations showing employees circumvented financial and procurement controls and embezzled over \$891,000 over several years. In this regard, we are confident that D.B. Frye and Associates will heed our recommendation and emphasize procedures to make sure all payments from project accounts are fully supported and made only for those expenses necessary for project operations.

Recommendations

We recommend you:

- 1A. Require the Owner/Agent to provide appropriate documentation to support the 585 payments valued at \$1,098,672 identified during the audit as unsupported project costs. Require the Owner/Agent to use non-project funds to reimburse the relevant project account for those costs that cannot be adequately justified.
- 1B. Instruct the Owner/Agent to emphasize procedures to make sure all payments from project accounts are made only for those expenses necessary to project operations. At a minimum, ensure Regional Asset Managers emphasize the need to:
 - Ensure costs paid to identity-of-interest companies are fair and reasonable.
 - Obtain and document sufficient number of bids from qualifying vendors to ensure goods and services are obtained at costs most advantageous to the projects.
 - Support all payments with detailed invoices and sufficient documentary evidence to show the basis for the cost, and the nature and extent of services or items provided.
 - Not charge the projects for Management Agent overhead expenses and allocated costs that should be borne by the Management Agent.

- 1C. Coordinate with the applicable HUD office to determine if additional monitoring efforts of D.B. Frye and Associates management agent operations are warranted at projects located outside of the State of Virginia. If suitable, take appropriate administrative actions against D.B. Frye and Associates as specified in the relevant Annual Contributions Contract and Regulatory Agreement.

Auditee Comments



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February 26, 2002

Daniel G. Temme
District Inspector General for Audit
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Dear Mr. Temme:

This is in reference to your February 14, 2002 draft audit memorandum regarding operations at the Stuart Gardens (Phases I & II) properties in Newport News, Virginia, and the Hilltop North and Southgate complexes in Richmond, Virginia. The Section 8 assistance for the Stuart Gardens properties is administered by VHDA, whereas the two Richmond properties are mod-rehab Section 8 complexes administered by the Richmond Redevelopment Housing Authority.

During your staff's field review, which extended through mid-year, considerable documentation was routinely provided in response to daily questions from your accountants. There was a very good dialogue during this period between our respective staff members and we had anticipated that we had successfully responded to most of your inquiries. However, in view of the numerous unresolved issues in the draft memorandum, we are preparing a detailed, point-by-point, written response to the audit observations. We are very confident that this documentation will successfully respond to most, if not all, of the issues raised by your staff.

This matter was the subject of a telephone discussion last week between Mr. Buck of your staff and Hugh Forehand, President of Frye Properties, which is the management agent for these properties. Mr. Forehand indicated that because of the number of remaining questions and our intent to submit a formal written response to each observation, and because details in the case of the Stuart Gardens properties (i.e. specific check numbers, etc.) were not received until Wednesday (February 13, 2002), we have been unable to complete our response to your questions on these properties. Our detailed response for Hilltop North, which will be presented in a tabbed binder, will be submitted to you by the end of this week. Since this effort is very time consuming, we request that we be allowed to delay submission of our response for the remaining properties until April 1. This additional time is especially important at this point in time since we are in the middle of the very time-consuming year-end audits for all properties in our portfolio.

In addition to the time required for this response, some aspects of this documentation are more complicated by virtue of the characteristics and situations unique to these properties. In the case of Southgate and Hilltop, Richmond HUD Area office staff can certainly confirm the difficulties at these properties over the last 3 to 4 years, which have been related to the administration of these respective HAP contracts by the Richmond Redevelopment Housing Authority. There is considerable material in HUD area office files, including letters and minutes of meetings, etc. between HUD and Hilltop North Associates LP and Richmond Investment Properties LP (which formerly owned Southgate) regarding the shortcomings of the Authority's administration of the HAP and irresponsible delays in approval of leases, among many other related issues, which necessitated the infusion of cash by the aforementioned owners on several occasions during the period encompassed by your audit. The Hilltop North property, which we still own, continues to struggle to meet revenue targets needed to properly operate this housing.

Similarly, Stuart Gardens, as we are sure you are aware, has been impacted by two defalcations by a 20-year site manager at Stuart Gardens. Fortunately, these situations were discovered, and the employee in question was fired, and along with the contractor in question, was prosecuted criminally. In this regard, a significant amount of the loss in question has already been recovered and we are confident that a 100% recovery is very possible. However, in conjunction with this matter, as will be noted in the information to be submitted, one of the primary issues, especially in the case of Stuart Gardens, is the availability of competitive bids for work undertaken with project funds during the period in question. Our package will indicate that bids were obtained in accordance with VHDA requirements, which clearly state that single source contracts are not allowed, that competing bids are required, and that this documentation should be retained in the property files, which are subject to semi-annual VHDA field audits. Unfortunately, as reported during the criminal investigations, all of the contract files at Stuart Gardens were removed from these properties, ostensibly by the manager in question, and were not located during the very extensive investigations related to the recent prosecutions.

Notwithstanding the above, we will do our very best to recreate these back-up files.

In reference to recommendation 1B in your draft memorandum, clearly stated procedures are in place to insure all payments from project accounts are made only for expenses to project operations, and that such transactions are handled in strict accordance with applicable HUD requirements. These requirements are outlined in the enclosed excerpts from the Frye Properties Operating Handbook. The adherence to these procedures is also closely connected with the oversight of property operations by Regional Asset Managers, more specifically described below. We are confident that these procedures, and our close scrutiny thereof, will respond to the issues outlined in Section 1B of your letter.

Frye Properties makes every effort to undertake work at costs that are fair and reasonable. This is particularly critical for all of the properties in question, which continue to be impacted by the absence of adequate HUD rent increases and uncontrollable operating costs like property and casualty insurance, which is especially difficult to obtain because of the very nature of these complexes. Frye Properties' employees are expected to, and do, obtain the best pricing available. Frye Properties employs a Purchasing Agent who compares pricing on a continuous basis and to hopefully insure that the best pricing is obtained in every case. All quantity

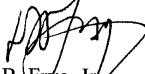
discounts received are passed directly to the property. It should also be noted that the undersigned, as General Partner for each of the entities in question, is only a partial owner and subject to scrutiny by other partners, and in his fiduciary capacity closely monitors costs, which translate to the "bottom line." Ironically, the other owners of Hilltop North and Southgate (before the latter was sold in 2001) were required to fund operating deficits for these two properties on several occasions because of the well-known aforementioned problems with RRHA.

As required in Frye Properties Policy 001B, Capital Improvements, 3 bids are required on capital expenditures of \$5,000 or more. Policy 015A, Purchase/Contract Authority, dictates that all expenditures of \$500 or more must be pre-approved by the property's Asset Manager. Moreover, no contractual agreements can be made without the approval of the Vice President for Administration or Construction. All contracts for services require the approval of the Site Manager and others as appropriate prior to submission of the invoice for payment.

All invoices are confirmed and attached to purchase orders or check requests. Each Asset Manager is required to review and initial purchase orders prior to submission for preparation of checks. Checks are prepared for signature and thereafter submitted to the Vice President for Administration for review and signature. Each check, and its back-up information, is reviewed carefully before signature. Any discrepancy is brought to the attention of the financial staff for correction, and as needed, to site staff personnel. Policies and procedures are reviewed quarterly at mandatory managers' meetings, and we welcome any suggestions to improve our operations.

We look forward to working closely with you and your staff, as well as the HUD Area office staff, to resolve these matters.

Very truly yours,



D.B. Frye, Jr.
General Partner

cc: Mr. Charles Famuliner

Schedule of Questioned Costs

<u>Recommendation Number</u>	<u>Unsupported 1/</u>
1A	\$1,098,672

1/ Unsupported amounts are those whose eligibility or reasonableness cannot be clearly determined during the audit since they were not supported by adequate documentation or due to other circumstances. Under Federal cost principles, a cost must be adequately supported to be eligible.

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