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June 3, 2002

2002-FW-1803

MEMORANDUM FOR: J. Tom Miller
Director
Oklahoma State Multifamily Program Center, 6IHM

/SIGNED/

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

SUBJECT: Complaint—Apache Trace Apartments
Guymon, Oklahoma

Based upon your complaint, we performed a limited review of Reid and Gary Strickland Company's (RGS) Cost Certifications of Apache Trace Apartments located in Guymon, Oklahoma.¹ The complaint alleged RGS made false claims in its required construction cost certification for Apache Trace Apartments. Our objectives were to determine the validity of the complaint and whether RGS submitted any unallowed costs in its cost certifications. We could not substantiate that RGS submitted any false claims. However, we concluded RGS claimed \$25,393 more than HUD regulations allowed.

To accomplish our objectives we interviewed HUD and RGS personnel. Further, we reviewed cost documentation provided by RGS to the HUD Office. We reviewed the General Requirements and Other Fees-Paid by Contractor portions of the cost certifications. Our scope included expenses from December 1, 1997, through September 15, 2000.

During our review, we noted HUD mistakenly disallowed legal fees twice during its review of RGS' cost. Thus, HUD needs to increase its next distribution to RGS by the \$9,387. Therefore, we recommend HUD's Oklahoma Multifamily Program Center disallow \$16,006 from RGS' next distribution.²

We provided a draft of the memorandum to RGS representatives and HUD's Oklahoma Multifamily Office on May 3, 2002. We asked for comments from RGS by May 22, 2002. RGS did not provide comments. HUD's Oklahoma Multifamily Program Center Director agreed with our findings.

¹ FHA Number 117-31185.

² Total amount determined ineligible \$25,393 less the effect of the duplicate disallowance of legal fees of \$9,387.

Within 60 days please give us, for each recommendation made in this memorandum a status report on: (1) corrective action taken; (2) proposed corrective action and date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directive issued because of this review.

If you have, any questions contact William W. Nixon, Assistant District Inspector General for Audit, at 817-978-9309.

Attachment

ATTACHMENT

Background.

HUD provides insurance under Section 221(d)(4) of the National Housing Act to assist private industry in providing comfortable and attractive rental accommodations for moderate-income families. Housing developed under Section 221 is intended to be of modest design that is pleasant and efficient and in keeping with the HUD's goals of providing affordable housing. G.C. Buildings, Inc. (the owner) financed the construction of Apache Trace Apartments with the proceeds of a loan from GMAC Commercial Mortgage Corporation (GMAC). HUD insured the loan against default.

Apache Trace Apartments, located in Guymon, Oklahoma, is a Section 221(d)(4) insured project with 144 market rate units.³ RGS and the owner signed a cost plus not to exceed construction contract for \$5,930,254 on December 1, 1997. The owner requested and HUD approved \$13,056 in change orders bringing the maximum construction contract to \$5,943,310. RGS began construction in December 1997.

On June 22, 1998, when the project was approximately 55 percent complete, a fire destroyed a substantial portion of the project. RGS filed a lawsuit against the owner disputing the distribution of the fire loss insurance proceeds paid by its insurance company. The lawsuit also determined the payment for the work necessary to bring the project back to the pre-fire loss condition. RGS and the owner entered into a Memorandum of Understanding on April 21, 1999, specifying rebuilding requirements to bring the project to the pre-fire loss condition and a new completion date.

On September 15, 2000, HUD approved construction as complete. Apache Trace began leasing units in June 2000. The owner assigned Apache Trace to HUD in May 2001. As of June 2001, Apache Trace had a 50 percent occupancy rate.

HUD regulations required separate cost certifications when there is new and rehabilitation work performed. Thus, HUD required two cost certifications:

1. A cost certification for the original construction, this included the construction before the fire and the construction to finish the project after the fire damage reconstruction and
2. A cost certification for the fire damage reconstruction. HUD did not finance the fire damage reconstruction costs. RGS' insurance paid for the fire damage reconstruction and the RGS escrowed the monies at GMAC.

Objectives, Scope, and Methodology.

Our objectives were to determine the validity of the complaint and whether RGS submitted any disallowed costs in its cost certifications. To accomplish our objective we interviewed HUD's Oklahoma Multifamily Program Office personnel and RGS personnel. Further, we reviewed cost

³ FHA Number 117-31185.

documentation submitted to the Oklahoma Multifamily Program Office by RGS. The review included analysis of the expenses, including supporting documentation, and a determination of their allowability per HUD regulations.

Our scope included expenses from December 1, 1997, the signing of the construction contract through September 15, 2000, the final inspection date. We performed our fieldwork from December 26, 2001, through March 4, 2001.

RGS' Cost Certifications Contained Ineligible Costs.

Our review concluded RGS claimed \$25,393 in ineligible costs per HUD regulations.⁴ Specifically, RGS claimed ineligible costs for equipment, documentation, overhead, travel, personnel, restaurants, and other costs.

Criteria.

HUD's regulation regarding Cost Certification is Directive 4470.2 REV-1 Chapter 5, titled *Allowable Costs to be Reported on Form HUD-92330-A*. We relied on the following clauses in Chapter 5 5-3 of the Directive during our review of RGS' Cost Certification General Requirements and Other Costs-Paid for by the Contractor:

- The contractor is to certify to the actual costs incurred in completing the project.
- The contractor can only include actual amounts paid in cash, for labor, materials for construction, equipment and fixtures, field engineering, sales taxes, workmen's compensation insurance, social security, public liability insurance, job overhead, and all other expenses directly connected with construction, and including general overhead expenses.
- The contractor *cannot* include in General Requirements any item of general overhead expense, "such as the salary of any employee whose activities are confined to work in the main office or any branch office of the contractor."
- For self-owned equipment, the contractor may certify to the cost of fuel, lubrication, normal expenditures for its equipment, maintenance, repair, and depreciation or 85 percent of the local lease rates for identical equipment.
- When certifying for 85 percent of the local lease rates, the charges cannot exceed the purchase price of the equipment.

⁴ This does not include costs that HUD's Oklahoma Multifamily Program Center had previously disallowed.

RGS claimed \$25,393 of ineligible costs.

In its cost certifications, RGS claimed \$25,393 for costs unallowable per HUD regulations. Specifically, these types of costs include equipment, documentation, overhead, travel, personnel, restaurant gift certificates, and other costs. See the following table.

Summary of RGS' Ineligible Costs

<i>Ineligible Costs</i>	<i>Amount</i>
Equipment	\$ 7,808
Documentation	7,526
Other	4,304
Overhead	4,112
Personnel	726
Travel	582
Restaurants	335
Total	\$25,393

Ineligible Equipment Expenses.

RGS included in its cost certifications \$7,808 in ineligible equipment expenses. Specifically, these expenses included claiming more than 85 percent of the local lease rate. Additionally, RGS claimed 85 percent of maintenance and repair costs in addition to the local lease rate for a 1994 GMC pick-up.

Directive 4470.2 REV-1 Chapter 5 5-3 H states for self-owned equipment, RGS may certify to the cost of fuel, lubrication, normal expenditures for its equipment, maintenance, repair and depreciation or 85 percent of the local lease rates for identical equipment. In addition, when certifying for 85 percent of the local lease rates, the charges cannot exceed the purchase price of the equipment.

RGS claimed 85 percent of the local lease rate for the small tools and field office trailer. RGS used the *Compilation of Nationally Averaged Rental Rates & Model Specifications for Construction Equipment* (Green Book) to determine its lease rates. However, for the small tools and field office RGS exceeded 85 percent of the lease rate printed in the Green Book. For instance, RGS charged \$25 per day for a miter saw when the Green Book amount was \$22. Further, for the field office trailer RGS claimed \$240 when the Green Book amount was \$204. For these two items, RGS claimed \$249 for small tools and \$3,507 for the field office trailer more than allowed. In total, RGS over-claimed \$5,887 for similar items.

Additionally, HUD previously disallowed \$54,500 of ineligible expenses regarding the 1994 GMC pick-up (truck) because RGS exceeded the truck's total cost of \$18,000. However, in RGS' cost certifications, it also included equipment maintenance and repair expenses for the

truck. HUD regulations only allow the 85 percent of local lease rate or the normal expenditures for maintenance and repair, not both. Also, HUD regulations require that the 85 percent of the local lease rate not exceed the purchase price of the equipment. Since RGS already claimed more than the truck's original cost and HUD had disallowed the excess, RGS could not also claim the normal expenditures for maintenance and repair. Contrary to this, RGS charged \$1,921 for the lease rate and maintenance and repair on the truck.

HUD's Oklahoma Multifamily Program Center should disallow the \$7,808 of ineligible equipment expenses.

Ineligible Documentation Expenses.

RGS included in its cost certifications \$7,526 in ineligible documentation expenses. Specifically, these expenses included \$7,182 of expenses incurred prior to the date the owner and RGS signed the construction contract, \$171 for sending documents to the consultants regarding the lawsuit filed after the fire on June 22, 1998, \$169 for copies made at RGS' main office and a \$4 error. HUD Directive 4470.2 REV-1 Chapter 5 5-3 A. 1. required RGS' cost certifications to contain only expenses directly connected with construction. However, none of these documentation expenses were directly related to construction. Thus, RGS claimed \$7,526 of ineligible documentation expenses and HUD should disallow the amount.

Other Ineligible Expenses.

RGS included in its cost certifications \$4,304 of other ineligible expenses. Specifically, these expenses included \$2,762 expenses incurred prior to the date RGS and the owner signed the construction contract and \$1,542 for towing the field office to and from Guymon, Oklahoma. HUD Directive 4470.2 REV-1 Chapter 5 5-3 A. 1. required RGS' cost certification to contain only expenses directly connected with construction. However, none of these expenses are directly related to construction. Thus, RGS claimed \$4,304 in ineligible other expenses and HUD should disallow the amount.

Ineligible Overhead Expenses.

RGS included in its cost certifications \$4,112 in ineligible overhead expenses. Specifically, these expenses included \$2,237 for copies made at RGS' home office and \$1,875 reimbursements to Strickland Management Corporation⁵ for telephone and long distance calls. Telephone calls and copies are not directly related to construction. Thus, RGS claimed \$4,112 ineligible overhead expenses and HUD should disallow the amount.

Ineligible Personnel Expenses.

RGS included in its original construction cost certification \$727 in payroll expenses for a job clerk who worked in the RGS' main office. HUD Directive 4470.2 REV-1 Chapter 5 5-3 B. 4.

⁵ Strickland Management Corporation is an identity-of-interest company of RGS.

required the salary of an RGS employee whose activities were confined to work in the main office or any branch office of RGS, shall not be included in General Requirements section of the cost certification. HUD regulations did not allow RGS to claim a main office employee's payroll expense. Thus, RGS claimed \$727 in ineligible personnel expenses and HUD should disallow the amount.

Ineligible Travel Expenses.

RGS included in its cost certifications \$582 for ineligible travel expenses. Specifically, these expenses included \$423 for travel by RGS' owner regarding the fire damage lawsuit, \$156 incurred prior to the date RGS and the owner signed the construction contract, and a \$3 error. HUD Directive 4470.2 REV-1 Chapter 5 5-3 A. 1. required RGS' cost certification to contain all expenses directly connected with construction. Because these travel expenses do not directly relate to actual construction, RGS submitted \$582 of ineligible travel expenses. HUD should disallow the amount.

Ineligible Restaurant Expenses.

RGS included in its cost certifications \$335 in ineligible restaurant expenses. Specifically, these included restaurant gift certificates for the Project Superintendent's birthday and meetings held at restaurants. HUD Directive 4470.2 REV-1 Chapter 5 5-3 A. 1. required RGS' cost certification to contain only expenses directly connected with construction. The restaurant expenses were not direct construction costs. Thus, RGS claimed \$335 of ineligible restaurant expenses and HUD should disallow the amount.

HUD underpaid \$9,387 RGS in a prior disbursement.

RGS' original cost certification amounted to \$6,081,248. However, this amount exceeded the not to exceed contract of \$5,943,310 by \$137,938. When HUD reviewed the cost certifications HUD disallowed \$147,325. However, in the \$147,325, HUD mistakenly disallowed legal fees of \$25,646 twice. Because HUD cannot pay more for the construction than allowed by the contract, even with the error, the most RGS should receive for the duplicated disallowed legal fees is \$9,387.⁶

HUD's Underpayment to RGS	
RGS' Original Construction Cost Certification Amount	\$6,081,248
Total of Not to Exceed Construction Contract	\$5,943,310
Difference	\$137,938
Amount HUD Disallowed	\$147,325
Maximum Returnable to RGS	\$9,387

⁶\$147,325 - \$137,938 = \$9,387

Recommendation:

We recommend the Oklahoma Multifamily Program Center Director:

1A. Disallow \$16,006⁷ from RGS' next disbursement.

⁷ \$25,393 - \$9,387 = \$16,006

SCHEDULE OF QUESTIONED COSTS

	<u>Ineligible Cost</u> ¹
1A Disallow \$16,006 from RGS' next disbursement	\$16,006

1 Ineligible costs are costs charged to a HUD-financed or insured program or activity that the auditor believes are not allowable by law, contract, or federal, state, or local policies or regulations.

DISTRIBUTION

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Guymon, Oklahoma

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