



Audit Report

District Inspector General for Audit
Rocky Mountain District

Mitchell Management
Denver, Colorado

Review of Management
Activities for Denver
Northeast Apartments,
Mitchell 66 Apartments, and
Rotella Park Manor

2002-DE-1001
March 15, 2002

Department of Housing and Urban Development
District Office of Inspector general For Audit
633 17th Street, 14th Floor
Denver, CO 80202-3607



Audit Report

District Inspector General for Audit Rocky Mountain District

Report: 2002-DE-1001 Issued: March 15, 2002

TO: Larry Sidebottom, Director, Denver Multifamily HUB, 8AHMLA

FROM: Robert C. Gwin, District Inspector General for Audit, 8AGA

SUBJECT: Mitchell Management
Denver, Colorado
Review of Management Activities for Denver Northeast Apartments, Mitchell
66 Apartments, and Rotella Park Manor

We performed an audit of the management activities of Mitchell Management, the management agent for three HUD insured multifamily projects located in the Denver, Colorado area. The three multifamily projects are Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor.

The overall objective of the audit was to assess Mitchell Management's operations and each of the three projects' compliance with HUD requirements. More specifically, the objectives were to determine the reliability of the organization's management controls for maintenance, use of project funds, ensuring tenant eligibility, HUD subsidy, and other management activities.

We appreciate the courtesies extended by the personnel of Mitchell Management and the on-site staff at the three projects Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor. In addition, we appreciate the information and cooperation provided by the staff of the HUD Office of Multifamily Housing.

Within 60 days please furnish this office, for each recommendation in this report, a status report on: (1) the corrective action, (2) the proposed corrective action and date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued related to this audit.

Should you have any questions, please contact Ernest Kite, Assistant District Inspector General for Audit, at (303) 672-5452.

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Executive Summary

We performed an audit of Mitchell Management, the Management Agent responsible for managing three HUD insured multifamily projects located in the Denver, Colorado area. The multifamily projects that Mitchell Management manages are Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor Apartments.

Mitchell Management, as Management Agent, is responsible for ensuring that the HUD insured properties are maintained in accordance with HUD standards and requirements. Mitchell Management's management control structure was not adequate to ensure that housing operations at the HUD insured properties were in compliance with HUD requirements. Management Controls for project maintenance, cash collections and accounting, tenant eligibility determination, and HUD subsidy payments are not reliable and need to be strengthened to improve the multifamily projects' housing operations. As a result of Mitchell Management's ineffective management control structure, the management agent is not meeting its management responsibility to ensure compliance with HUD requirements and to maintain the projects in decent, safe, and sanitary condition.

We found that the projects were not maintained in a decent, safe, and sanitary condition. The overall effect of not performing the necessary maintenance of the projects and related housing units is that the tenants are occupying units that fail to meet the minimum HUD requirements for being decent, safe, and sanitary. Furthermore, deficient maintenance of the projects' buildings and surrounding grounds affects the tenants' ability to live in a healthy and hazard-free environment. In addition, the projects had excessive vacant units that had not been repaired timely. The vacant units need to be repaired timely in order to accommodate those families waiting for available housing. As a result of the deficient maintenance, the projects are unable to generate the maximum amount of revenues that is needed to fund the projects' operations.

The Management Agent needs to improve its occupancy procedures over the three projects' tenant and security deposit accounting records, and the tenant eligibility determination and continued occupancy documentation. This needs to be done to bring the projects' occupancy procedures in conformity with HUD requirements, as well as, to improve the Management Agent's administrative control and oversight over its tenant occupancy activities.

The Management Agent has not established the minimum required accounting records for the three projects and those that are being kept are not maintained timely and accurately. The records that have not been properly established and maintained are the tenant accounts receivable and security deposit subsidiary ledgers and the accounts payable ledgers. The accounting for tenant activities has been basically on a cash basis rather than on an accrual basis. This situation, plus the fact that the accounting records are not being maintained in a timely manner, limits the Management Agent's ability to properly administer and monitor its housing activities.

Also, the Management Agent needs to establish better control over the receipt and deposit of its project rents and miscellaneous monies. Improvement is needed to ensure that monies are timely deposited into the projects' bank accounts.

Our review identified basically the same conditions that had been presented in reports issued by HUD and in reports issued by the projects' independent public accountant. Even with these previous reports identifying needed management changes and improvements, we found that limited changes had been made by the Management Agent in the operations of the HUD insured projects.

Audit Objectives

The overall objective of the audit was to assess Mitchell Management's operations and each of the three projects' compliance with HUD requirements. More specifically, the objectives were to determine the reliability of the organization's management controls for maintenance, use of project funds, ensuring tenant eligibility, HUD subsidy, and other management activities.

Properties are not maintained in a decent, safe, and sanitary condition

We found that the three projects, Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor, are not being maintained in a decent, safe, and sanitary condition. The conditions we found were basically the same as had been identified by HUD in their previous inspections of the projects. While HUD has pointed out the need to establish adequate procedures to correct the identified maintenance deficiencies, the Management Agent has not taken the necessary corrective action. As a result, maintenance deficiencies continue to exist.

In addition, the lack of maintenance to vacated units has resulted in the projects having a large number of unrentable vacant units in each project at any given point in time. These vacancies continue even though the projects have needy families on the projects' waiting lists for available apartments. The high number of vacancies has reduced the projects' rental income and limited the amount of funding available to finance project operations and maintenance.

The maintenance procedures in place at the projects at the time of our review were informal and ineffective and lacked any meaningful oversight and supervision by the management agent, Mitchell Management.

Improved controls needed over occupancy procedures

Mitchell Management needs to improve its occupancy procedures over the three projects' tenant and security deposit accounting records, and the tenant eligibility determination and continued occupancy documentation. This needs to be done to bring the projects' occupancy procedures in conformity with HUD requirements, as well as, to improve the Management Agent's administrative control and oversight over its tenant occupancy activities.

For the three projects, the Management Agent has not established the required tenant accounts receivable and tenant security deposit subsidiary ledgers that are to be posted and

maintained on an accrual basis and in a timely manner. The tenant records kept by the projects were on a cash basis and primarily only recorded payments by its tenants. The Management Agent bookkeeper maintains the official tenant records for the projects, however these records were not maintained on a current basis. In fact, these records had not been posted for up to seventeen months. In addition, the tenant records kept by the Management Agent bookkeeper were used only to support accounting entries to the projects' general ledger and were not to supplement the daily occupancy operations at the projects. As a result, the Management Agent and its project staff are unable to readily identify the balance due from any of its tenants. Any determination of a tenant accounts receivable balance can only be obtained by utilizing informal records kept at the on-site project office.

The Management Agent was not processing security deposit refunds for its vacated tenants in a timely manner. More specifically, the security deposit refunds had not been processed for some tenants even though the tenants had vacated their units up to six or more months prior.

For two of the projects, Denver Northeast Apartments and Mitchell 66 Apartments, the Management Agent was not adequately documenting its tenant eligibility and continued occupancy certifications. As a result, the projects were unable to support the eligibility of its tenants and ensure the amount of rent being charged to its tenants was correct.

The books of account are not complete and accurate

The books and accounts being maintained by the Management Agent, Mitchell Management, for the three projects were not being kept in accordance with HUD requirements. The books and accounts for these projects did not contain all of the records and were not complete and accurate. More specifically, the following deficiencies were noted:

- Accounting records were not kept current;
- Subsidiary ledgers for accounts payable were not kept;
- Inaccurate allocation of costs between projects; and
- Required independent audit reports were submitted late.

The accounting responsibilities for the projects have been vested with the Management Agent bookkeeper that has been unable to post and maintain the records in a timely manner. As a result, the Management Agent has had limited financial information with which to administer and monitor its HUD insured projects. In addition, without current financial information, the Management Agent has been unable to ensure that its project funds are being properly and effectively used for project activities.

Improved controls
needed over cash
receipts

The Management Agent needs to improve management controls over cash receipts to ensure that all cash collections are properly collected, deposited, and recorded in the projects' books of account. The system for Tenants Accounts Receivable at Denver Northeast Apartments and Mitchell 66 Apartments is informal and less than adequate for collecting monies owed to the projects. Laundry income for Denver Northeast Apartments and Mitchell 66 Apartments is received, deposited, and recorded into the books of account by the Bookkeeper of the Management Agent. All of the functions for handling and recording laundry revenue for the two projects should not be vested in the same individual. In addition, cash receipt deposits for the projects have not been made timely.

Improved controls are needed over the handling and depositing of project revenues in order to insure that the monies are properly received and recorded. Furthermore, timely deposits increase the availability of the monies for project use.

Auditee Comments

The results of the audit were discussed with officials of the Management Agent during the course of the audit, and at an exit conference on February 11, 2002. The draft audit report and related audit findings and recommendations were provided to the Management Agent at the exit conference, for their review and comment. The Management Agent officials provided their written response to our draft audit report on March 14, 2002. Their complete written response is included in Appendix 1.

The Management Agent Officials stated that a formal written response would be submitted after the final report is issued. According to their written response, they are aware of the items of concern contained in the draft report and have instituted corrective procedures to correct all deficiencies. Their response includes a brief status update for each project. A MIO plan for Denver Northeast, addressing all maintenance and repairs indicated, has been submitted to HUD for review. Mitchell 66 is under contract for sale and Rotella Park Manor is in the final stages of negotiation for sale.

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Abbreviations:

HUD Department of Housing and Urban Development

Introduction

Three projects, Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor, were established to provide decent, safe, and sanitary dwelling accommodations for eligible residents in Denver and Thornton, Colorado. Mitchell Management was created to ensure, among other duties, that these properties were maintained and operated according to the HUD standards and requirements.

Denver Northeast Apartments is owned by Denver Northeast Associates. Mitchell 66 Apartments is owned by Mitchell 66 Associates, LLP. Rotella Park Associates, Ltd owns Rotella Park Manor. Mr. Bertram Bruton is the general partner of each of these Associates, as well as, the owner of Mitchell Management, which is the management agent for all three projects.

In 1979, Denver Northeast Associates was established to obtain an interest in, develop, and operate Denver Northeast Apartments. Denver Northeast Apartments is financed under Section 221(d)(4) of the National Housing Act, with rental assistance under Section 8 of the National Housing Act. This project has 17 units, all of which are eligible for Section 8 housing assistance payments.

The construction of Mitchell 66 Apartments was completed in 1976. Mitchell 66 is financed under Section 236 of the National Housing Act, with rental assistance under Section 8 of the National Housing Act. This project has 86 units, 83 of which are eligible for Section 8 housing assistance payments. The subsidized units are covered under two HUD Housing Assistance Payments Contracts.

The construction of Rotella Park Manor Apartments was completed in 1983. Rotella is financed under Section 221(d)(4) of the National Housing Act, as amended, with rental assistance under Section 8 of the National Housing Act. This project has 81 units, all of which are eligible for Section 8 housing assistance payments.

The Colorado Housing and Finance Authority is the mortgage holder and servicer for Denver Northeast Apartments. The Federal National Mortgage Association is the mortgage holder, while GMAC Commercial Mortgage Corporation is the mortgage servicer for Mitchell 66 Apartments.

The Colorado Housing and Finance Authority was the mortgage holder and servicer for Rotella Park Manor Apartments. However, the Colorado Housing and Finance Authority accelerated the mortgage for Rotella Park Manor Apartments, and consequently assigned the mortgage to HUD. As of June 28, 2001, HUD became the mortgage holder and servicer for Rotella Park Manor Apartments and has subsequently initiated foreclosure proceedings.

Mitchell Management has been the only management agent for both Denver Northeast and Mitchell 66 Apartments. Rotella Park Manor has undergone several management agent changes during its existence.

Mitchell Management managed Rotella Park Manor from 1982 through 1992. Due to poor management, in 1993, the Colorado Housing and Finance Authority and HUD required a new management company to operate Rotella Park Manor. The project owner hired a new

management company, but in 1996, the new management company was terminated and the management of the Rotella Park Manor project was again given to Mitchell Management. Due to the distressed financial condition of the project, Mitchell Management was granted an administrative fee of \$8 per unit per month, rather than a management fee. In July 1999, HUD notified the project owner that the project needed to hire a separate “Arm’s Length” management company to manage the project. Presently, the project has not obtained the services of a new management agent.

During the audit period, HUD had conducted several reviews of the projects and their related management operations. The conditions presented in this report parallel those reported by HUD in their previous reports. The results of the HUD reviews are briefly discussed below by project:

Denver Northeast Apartments

The HUD Real Estate Assessment Center conducted physical inspections of Denver Northeast Apartments in 1999 and 2000. Based upon the inspections, the project was given low scores in both years because of numerous health and safety violations that were found. In March 2000, the project was referred to the HUD Departmental Enforcement Center for enforcement action. The referral was based upon the deficiencies noted in the project’s physical condition in the 1999 inspection. The condition of the property and dwelling units are contrary to the provisions of the Regulatory Agreement and the HUD Housing Assistance Payments Contract.

Mitchell 66 Apartments

The HUD Real Estate Assessment Center conducted physical inspections of Mitchell 66 Apartments in 1999 and 2000. The project was given low scores for both years because of needed maintenance and health and safety deficiencies that were noted. Such deficiencies are contrary to the provisions of the Regulatory Agreement and the HUD Housing Assistance Payment Contract.

Rotella Park Manor

The HUD Real Estate Assessment Center conducted a physical inspection of Rotella Park Manor in 1999. The project received a very low physical condition score due to the numerous health and safety violations that were identified. As a result, Rotella Park Manor was referred to the HUD Departmental Enforcement Center in November 1999 for enforcement action. In 2000, the HUD Real Estate Assessment Center conducted an additional physical inspection of Rotella Park Manor. Again, the project received a very low physical condition score due to the numerous health and safety violations that were identified.

In March 1999, the Denver Multifamily HUB conducted a Comprehensive Management Review of the project. The Denver Office gave the project an overall unsatisfactory rating because of the numerous HUD contract violations that were found. The review pointed out deficiencies in three major categories: Maintenance and Security, Financial Management, and General Management Practices.

Our audit identified similar conditions as those presented in previous HUD review reports. Although HUD did not perform a management review of the Denver Northeast Apartments or

Mitchell 66 Apartments projects during our audit period, we identified deficiencies in the management and operations of these two properties that were similar to the deficiencies HUD noted during their review of Rotella Park Manor. We found that the organization's management controls for maintenance, cash, and tenant eligibility, for the three projects, are not reliable enough to ensure compliance with HUD requirements. We found that the properties were not being maintained in a safe, decent, and sanitary condition. Mitchell Management was created to ensure, among other duties, that the projects were maintained according to the standards of HUD. Mitchell Management has not performed all of its obligations, since the controls are not reliable enough to ensure compliance with HUD requirements.

Audit Objectives and Methodology

The overall objective of the audit was to assess Mitchell Management's operations and each of the three projects' compliance with HUD requirements. More specifically, the objectives were to determine the reliability of the organization's management controls for maintenance, use of project funds, ensuring tenant eligibility, HUD subsidy, and other management activities.

To accomplish our objectives, we reviewed the procedures in place over the key areas of operations for each project. The key areas included maintenance, project funds, tenant eligibility, and HUD Section 8 subsidy. We interviewed officials of Mitchell Management and staff at the projects Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor. In addition, we interviewed HUD officials of the Denver Multifamily HUB. We also examined the various accounting and other documents of these organizations.

Scope

Our audit generally covered the period January 1, 1999 through December 31, 2000, and was expanded, as necessary, to fully accomplish our audit objectives. We conducted our review from February 2001 to May 2001. Our audit was performed in accordance with generally accepted government auditing standards. The completion of our review was interrupted by situations that necessitated reassignment of staff.

Generally accepted government auditing standards

Considering our scope adjustment, our review was performed in accordance with generally accepted government auditing standards.

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Findings

Finding 1

Deficient Maintenance Procedures and Controls

In accordance with HUD Regulations, the three projects managed by Mitchell Management are to be maintained in a decent, safe, and sanitary condition. In addition, the properties are to be free of health and safety hazards. We found that the three projects, Rotella Park Manor, Denver Northeast Apartments, and Mitchell 66 Apartments, are not being maintained in a decent, safe, and sanitary condition. The conditions we found were basically the same as had been identified by HUD in their previous inspections of the projects. While HUD has pointed out the need to establish adequate procedures to correct the identified maintenance deficiencies, the management agent has not taken the necessary corrective action. As a result, maintenance deficiencies continue to exist.

In addition, the lack of maintenance to vacated units has resulted in the projects having a large number of unrentable vacant units in each project at any given point in time. These vacancies continue even though the projects have needy families on the projects' waiting lists for available apartments. The high number of vacancies has reduced the projects' rental income and limited the amount of funding available to finance project operations and maintenance.

The maintenance procedures in place at the projects at the time of our review were informal and ineffective and lacked any meaningful oversight and supervision by the management agent, Mitchell Management.

Project properties and units must be in good repair and condition, and habitable

The Regulatory Agreement between HUD and each of the three projects, Rotella Park Associates, Denver Northeast Associates, and Mitchell 66 Associates, requires the owners to maintain the mortgaged premises, accommodations, and the grounds and equipment appurtenants in good repair and condition. The physical condition standards required by HUD under the Regulatory Agreements and the related HUD regulations and handbooks, stipulate that the project units must be decent, safe, sanitary, and in good repair and habitable. The site components, such as fencing, grounds, lighting, parking lots, walkways, etc., are to be free of health and safety hazards and be in good repair. The Regulatory Agreements also state that without the prior written approval of the Secretary, owners shall not permit the use of the dwelling accommodations of the project for any purpose except the use which was originally intended.

In addition, the HUD Housing Assistance Payments contracts with the three projects contain similar requirements that the projects and related dwelling units are to meet the decent, safe,

and sanitary standards. HUD housing assistance payments are only to be paid to those dwelling units that meet the HUD housing standards.

The projects are to establish and maintain a reserve fund for replacements and to make monthly deposits to the reserve fund. The fund is to be used to finance capital items such as nonroutine repairs of building roofs, heating systems, etc.

Properties are not decent, safe, sanitary, and in good repair

Our review found that the three projects, Rotella Park Manor, Denver Northeast Apartments, and Mitchell 66 Apartments, were not being maintained according to HUD's physical condition standards. More specifically, we noted that the properties:

- Are not decent, safe, sanitary and in good repair; and
- Have excessive unrepaired vacant units.

Prior HUD inspections have found the projects in an unacceptable physical condition

Previously, HUD conducted several inspections of the projects and has found them to be in an unacceptable physical condition. Dwelling units have been found to not fully comply with the decent, safe, and sanitary condition required by HUD. In addition, the grounds of the projects have not been free of health and safety hazards, and in good repair.

At the time of our review, the latest inspections that had been conducted by the HUD Real Estate Assessment Center were in September 2000 for Rotella Park Manor and in November 2000 for Denver Northeast Apartments and Mitchell 66 Apartments. The maintenance deficiencies noted by HUD included the following items listed by project:

Rotella Park Manor

- Unrepaired balcony roofs/floors;
- Damaged and/or missing roof shingles;
- Broken or missing breezeway windows;
- Damaged steps;
- Damaged, inoperable, or missing light fixtures;
- Damaged or burned surrounding property fence; and
- Potholes/Loose materials in the Parking lots Driveways and Roads.

Denver Northeast Apartments

- Inoperable smoke detectors,
- Broken windows,
- Holes in the ceiling, and
- Parking lots contain cracks, potholes, etc.

Mitchell 66 Apartments

- Mold and mildew,

- Ceilings: water stains and peeling paint,
- Floor covering damage,
- Holes in exterior walls, and
- Broken windows.

Projects' physical condition is still deficient

We inspected the grounds and selected units within the three projects in February and March 2001 and found that many of those conditions identified by the HUD Real Estate Assessment Center still existed. The following pictures of Rotella Park Manor illustrate the physical condition of the grounds of the project.



Broken window in a breezeway at Rotella Park Manor.



Water damage caused by broken boiler located in the hallway of a Rotella Park Manor building.



Uncovered drainage pipe located in front of one of the buildings at Rotella Park Manor.

These three deficiencies as pictured here existed at the time of our inspection on February 27, 2001. Similar deficiencies were noted in HUD's previous inspection on September 28, 2000, approximately five months earlier. Corrective action was not taken by the project management agent to address these maintenance deficiencies.

The following pictures illustrate the maintenance deficiencies we noted during our March 29, 2001 inspection of selected units at the two projects Denver Northeast Apartments and Mitchell 66 Apartments.



Broken window located in the infant's bedroom of an apartment at Denver Northeast Apartments.



Tiles are missing from the bathtub of a unit in Mitchell 66 Apartments. Mold and mildew are in the grout areas of the bathtub.



Paint peeling from the ceiling in one tenant's bathroom in Mitchell 66 Apartments.

Similar deficiencies as these had been noted in HUD's previous inspections of the projects on November 6, 2000. We found instances whereby the management agent had not taken corrective action to correct these deficiencies.

Tenants are not living in a safe and hazard-free environment

The overall effect of not conducting the necessary maintenance of the projects and related housing units is that the tenants are occupying units that fail to meet the minimum HUD requirements for being safe, decent, and sanitary. Furthermore, deficient maintenance of the projects' buildings and surrounding grounds impacts the tenants' ability to live in a healthy and hazard-free environment.

Excessive vacant units in an unrepaired condition

At the time of our review, the projects being managed by Mitchell Management had a high number of vacant units that were not ready to be rented. Some of these units had been

vacant for up to 16 months. The impact was that units were not being used to house needy tenants who were on the projects' waiting lists for available apartments.

For Rotella Park Manor, 6 out of the 81 total units available in the project, or 7 percent, were vacant at the time of our review. Out of the 19 units that were vacant in 2000, there were 11 units that remained vacant longer than two months. For the units that remained vacant over two months, the number of months that the units were vacant ranged from 3 months to 16 months. The number of units vacant in any one month during 2000 ranged from 3 units to 10 units per month.

During our inspection of vacant units, we noted that one unit has been vacant since June 1999. This unit was being used to cannibalize small maintenance parts for other dwelling units in the project. Management officials stated that this was done since the project could not afford to purchase the parts they needed for other occupied units. During our inspection of this unit, the management officials advised us not to open the refrigerator. The officials explained that the power to the refrigerator had been shut off before the last tenant was evicted and the food has spoiled and is infested with maggots. The kitchen of this unit is shown in the following picture.



Food and containers left in this unit after it was vacated in June 1999, therefore, the unit was subject to infestation.

For Denver Northeast Apartments, 1 out of the 17 total units available in the project, or 6 percent, were vacant at the time of our review. Of the 6 Denver Northeast Apartment's units that were vacant in 2000, there were 5 units that remained vacant longer than two months. For the units that remained vacant over two months, the number of months that the units were vacant ranged from 4 months to 10 months.

For Mitchell 66 Apartments, 10 out of the 86 total units available in the project, or 12 percent, were vacant at the time of our review. Of the 25 Mitchell 66 Apartment's units that were vacant in 2000, there were 24 units that remained vacant longer than two months. For the units that remained vacant over two months, the number of months that the units were vacant ranged from 3 months to 11 months.

During our inspection of the vacant units, we noted that one of Mitchell 66's units has been vacant since June 2000. This unit was being used for storage and for parts. Items that are needed, such as doorknobs, drawers, light fixtures etc., are taken from this unit and used to replace the needed item in other units. This is illustrated in the following picture.



Tiles and bathtub parts taken from a vacant unit to replace parts in occupied units at Mitchell 66 Apartments.

Vandalization of vacant units increases maintenance expenses while decreasing income available for repairs

When the units remain vacant, the vacant units are often vandalized resulting in increased repairs and related costs to be funded by the project. For example, someone had recently tried to bust in the front door of one of Mitchell 66 Apartments' units. The doorframe will have to be replaced.

Project officials apprised us that they must continually repair the vacant units that are vandalized. This takes maintenance staff time and materials to repair the damaged units and thereby reduces the amount of time and materials that the project could use on other needed project maintenance efforts.



Damaged door jam of a vacant unit caused by someone kicking in the door.

Excessive vacancies reduce the amount of rental income to the projects

Units that are vacant for extended periods of time also prevent the projects from realizing the maximum rental income from the units. This loss in project revenue greatly impacts the projects' ability to meet its financial obligations. Reduced project revenue limits the amount of monies available to perform needed project repairs and upkeep. Limited funds to finance dwelling units repairs further impacts the projects' ability to rehabilitate vacant units for occupancy. Unrepaired units cannot be rented to those needy families on the projects' waiting list resulting in the loss of rental income. Thus, the cycle continues. Only when the units are rented can this endless cycle be broken.

During the last three fiscal years ending December 31, 2000, the projects have shown a significant loss in project revenues from the excessive vacancies and that the amount of lost rental income, for the most part, is increasing each year. This is illustrated in the following chart:

Fiscal Year	Rotella Park	Mitchell 66	Denver Northeast
1998	\$ 29,740	\$ 19,073	\$ 2,734
1999	43,049	13,770	6,906
2000	<u>49,670</u>	<u>47,408</u>	<u>16,979</u>
TOTALS	<u>\$ 122,459</u>	<u>\$ 80,251</u>	<u>\$ 26,619</u>

This chart shows that Rotella Park Manor, Mitchell 66 Apartments, and Denver Northeast Apartments have lost revenues totaling \$122,459, \$80,251, and \$26,619, respectively, for not renting its vacant units during the three-year period ending December 31, 2000. These funds could have greatly improved the projects' ability to finance needed repairs.

Management agent and project officials apprised us during the course of our review that they have been unable to perform needed repairs to its units because of a shortage of operating funds. This has been further illustrated by the fact that many of the suppliers for maintenance parts and/or services have required the projects to prepay purchases before the goods and/or services were provided. Also, Rotella Park Manor was unable to pay the monthly deposit into the projects reserve for replacement account as required by HUD.

In our opinion, one of the main contributing factors for the absence of financing needed repairs to the projects has been the loss of revenues from unoccupied vacant units.

The maintenance procedures in place at the projects at the time of our review were informal and ineffective and lacked any oversight and supervision by the management agent, Mitchell Management. More specifically, we noted that the projects:

- Lacked an effective unit inspection and work order system,
- Exercised limited control and supervision of its maintenance staff, and
- Received limited oversight and direction from the projects' management agent.

These three areas are discussed below.

Inspection and work order system is deficient

First, the projects did not have an effective inspection and work order system. At the time of our review, the projects were not always performing a move-out inspection of each vacated unit. If an inspection was performed, the inspection form often times did not fully identify the repairs that were needed. Furthermore, needed repairs were not documented in the projects' work order system to show what repairs were needed and whether it was subsequently repaired. As a result, the projects' staff could not readily identify what maintenance work was needed or what repairs if any should be charged to the vacated tenant.

In addition, the projects did not always perform a move-in inspection with the new incoming tenant to ensure that the dwelling unit was suitable for renting and that all previously identified repairs had been made. In one of the sample cases we reviewed, we identified that the tenant had moved into the unit without all of the previously identified repairs being corrected. As a result, the new tenant had to request needed repairs to be made immediately after the tenant moved into the unit. Without the project performing all needed repairs before a tenant moves into a unit, the project has a limited basis with which to charge the new tenant for any applicable repairs.

The projects have not implemented a formal procedure to perform the required annual inspection of each dwelling unit. We noted that when the projects do perform an interim annual inspection, any identified maintenance deficiencies are not always recorded on the projects' work order system. As a result, the projects have limited assurance that all needed repairs are clearly identified and assigned to its maintenance staff for correction. In addition, we observed that damages were not clearly identified as being tenant caused and therefore, no charges were assessed against the tenant for their caused damages.

The projects did not fully utilize its work order system to record all needed maintenance requests and items. In addition, the work orders in most instances did not identify exactly what work was performed showing time and materials used nor identify whether such repairs were chargeable to the tenant or not. As a result, the projects are unable to clearly show that all needed maintenance repairs were performed and whether the repairs were for tenant caused damages and chargeable to the applicable tenant. If tenants are not charged or do not pay for their unit damages, then project funds that are limited must be used to finance the repairs.

Control and oversight of maintenance staff and related work is deficient

Second, the projects lacked sufficient control and oversight over its maintenance staff and related maintenance work. While the maintenance staff at the projects perform maintenance work, the nature and extent of the staffs' maintenance efforts is not clearly identified. Not all maintenance is reflected on the projects' work order system and in those instances where work orders are used, details of the maintenance services provided is not shown. As a result, the projects are unable to clearly identify what maintenance repairs have been performed and which repairs remain to be made. Without a formal maintenance record keeping system, project management has reduced accountability over its maintenance staff and related work.

The projects have also followed the practice of allowing project staff, including maintenance employees, to perform certain maintenance activities, such as cleaning and repairing vacated dwelling units, under a separate contract. In such instances, the staff prepares a contract proposal of what work is to be done and the lump sum cost amount of the contract. Once the work is performed, the contract proposal is submitted to the management agent for payment.

The contract proposals generally describe the work to be performed, such as, cleaning a particular vacant unit. They do not, however, specify the details of the work to be performed. The proposals did not identify the amount of time that would be needed to fulfill the contract proposal. According to the

maintenance staff we interviewed, the proposals are signed and dated when the proposals are submitted to the management agent for payment. This means that work is performed without a formal signed contract proposal and the proposal is the document used to process a payment by the management agent. Without details of the work to be performed, the projects' management cannot identify the nature and extent of the proposed work nor to identify the actual maintenance work and related time performed.

Project staff apprised us that the contract work, which is to be performed after regular work hours or on weekends, is generally performed during the employees' regularly scheduled workweek. The addition payment for contract work during regularly scheduled hours would constitute duplicate compensation. Without sufficient records to identify exactly when the contract work is performed, project management is unable to ensure that its employees are not performing contract work at a time when the staff is being compensated as regular project employees.

Management agent oversight and direction of maintenance activities is deficient

Third, the projects receive limited oversight and direction from the management agent in connection with project maintenance. The responsibility for ensuring that the projects perform the needed repairs rests with the management agent, Mitchell Management. However, the project managers have not been given specific guidance and direction on what procedures are to be followed in connection with unit inspections, assigning and using work orders for necessary repairs, controlling maintenance staffs' time and performance, and assessing tenants for tenant caused damages. In addition, the management agent has not taken the necessary actions to ensure that the projects are carrying out their maintenance responsibilities and duties in an effective and timely manner.

HUD in its previous site inspections has identified numerous health and safety violations at the projects but the management agent has not taken the initiative to ensure that such identified maintenance deficiencies are corrected. This is evident from the fact that many of these previously identified maintenance deficiencies had not been corrected when we conducted our inspection of the projects.

Furthermore, the projects continue to show an increase in the number of vacant units that are unsuitable for renting to needy tenants. Better oversight and action is needed by the management agent to reduce this trend. The management agent needs to establish and maintain an effective and timely maintenance system.

Recommendations

We recommend that the Denver Multifamily HUB:

- 1A Require the management agent to establish and implement an effective inspection and maintenance work order system for the projects that will insure that needed project maintenance and repairs are properly and timely performed. This would include:
- Unit inspections are conducted within conformity with HUD requirements and identified maintenance deficiencies are properly reflected in the project's work order system.
 - Project and unit repairs are properly recorded and documented in the project's work order system and clearly showing the work performed, time involved, and materials used with a notation as to whether such repairs are chargeable to the particular tenant for tenant caused damages.
 - Use of contract proposals for performing maintenance work by project staff is discontinued. Additional maintenance work performed outside of the employees' regular 40-hour workweek should be compensated to the employee as over time.
 - Vacant units are promptly cleaned and repaired in order that the units can be leased to a new tenant.
 - Sufficient oversight and monitoring is implemented by the management agent over the maintenance activities of the projects and take any needed action to ensure that the projects and related units are properly maintained.
 - All previously HUD identified maintenance deficiencies for the projects are promptly and properly corrected.
 - The reserve for replacement fund for Rotella Park Manor will be fully funded and the required monthly payments to the fund will be made.
- 1B Provide the necessary guidance and direction to the management agent for the project to ensure that that Recommendation 1A is implemented. If the management agent is unable or unwilling to implement the recommendation, then HUD should take any other appropriate action to ensure compliance.

- 1C After the procedures in Recommendation 1A above have been implemented, ascertain that the projects' established procedures conform with HUD requirements, and are effectively ensuring that needed project repairs and maintenance are being properly performed.

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Finding 2

Improvement Needed over Occupancy Procedures

Mitchell Management, as the Management Agent for the three HUD insured projects, Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor, needs to improve its occupancy procedures over the projects' tenant and security deposit accounting records and tenant eligibility and continued occupancy documentation. This needs to be done to bring the projects' occupancy procedures in conformity with HUD requirements, as well as, to improve the Management Agent's administrative control and oversight over its tenant occupancy activities.

For the three projects, the Management Agent has not established the required tenant accounts receivable and tenant security deposit subsidiary ledgers that are to be posted in a timely manner and maintained on an accrual basis. The tenant records kept by the projects were on a cash basis and primarily only recorded payments by its tenants. The Management Agent bookkeeper maintains the official tenant records for the projects, however these records were not maintained on a current basis. In fact, these records had not been posted for up to seventeen months. In addition, the tenant records kept by the Management Agent bookkeeper were used only to support accounting entries to the projects' general ledger and were not to supplement the daily occupancy operations at the projects. As a result, the Management Agent and its project staff are unable to readily identify the balance due from any of its tenants. Any determination of a tenant accounts receivable balance can only be obtained by utilizing informal records kept at the on-site project office.

The Management Agent has not established and maintained the required tenant security deposit subsidiary ledgers in conformity with HUD requirements or in a timely manner. In addition, the Management Agent was not processing security deposit refunds for its vacated tenants in a timely manner. More specifically, the security deposit refunds had not been processed for some tenants even though the tenants had vacated their units up to six or more months prior.

For the Denver Northeast Apartments and Mitchell 66 Apartments projects, the Management Agent was not adequately documenting its tenant eligibility and continued occupancy certifications. As a result, the projects were unable to support the eligibility of its tenants and ensure the amount of rent being charged to its tenants was correct. Also, the on-site staff for the Denver Northeast Apartments project was utilizing the incorrect contract rents when it prepared its monthly HUD Housing Assistance Payment Voucher for submission to the Colorado Housing and Finance Authority for processing. As a result, the Colorado Housing and Finance Authority had to correct the monthly voucher before it could be submitted to HUD for payment. Had this not been done, HUD would have paid the incorrect Housing Assistance Payment amount.

Specific tenant accounting, selection, and occupancy requirements are to be followed

The Regulatory Agreements and Housing Assistance Payments Contracts between the project owners and HUD for the three projects stipulate certain provisions to be followed in the leasing and occupancy of the project units to low and moderate income families. These requirements are detailed in certain HUD handbooks.

For each of three projects, the Project Owners' and Management Agents' Certification state that the Management Agent will establish and maintain a comprehensive system of records, books, and accounts in a manner conforming to HUD directives.

HUD requires accounting records to be maintained for transactions dealing with the projects' tenants. The provisions, as set out in the *Financial Operations and Accounting Procedures for Insured Multifamily Projects Handbook*, stipulate that subsidiary tenants accounts receivable and security deposits ledgers be maintained on a current and accurate basis. These records are to detail the projects' transactions with their tenants and serve as a subsidiary ledger for certain accounts in the projects' official general ledger. The tenant subsidiary records form the key record for accounting for tenant transactions on a daily basis. These subsidiary records are to be maintained on an accrual basis and reflect the monthly rental assessments, charges for tenant caused damages, security deposit fees, tenants payments, and a ready balance of any funds due the projects by the individual tenants.

Under the provisions of the Regulatory Agreement and Housing Assistance Payments Contracts with HUD, the project owners are to follow certain requirements for the leasing and continued occupancy of the project dwelling units. More specifically, the projects are to properly document the eligibility of their tenants before their move-in to the projects and to annually recertify the tenants' eligibility afterwards. The certifications form the basis for the tenant's monthly rent.

Tenant accounting and leasing requirements not fully implemented or documented

At the time of our review, the Management Agent for the three projects was not maintaining and documenting the required tenant accounting records. Basically, the tenant accounting records were not being maintained in accordance with HUD requirements and in a current and accurate manner. Furthermore, the Management Agent was not maintaining and documenting the required selection and occupancy records for two of the projects. The tenant files did not always support tenant eligibility. Without the required tenant accounting and eligibility records, the Management Agent could not readily identify the financial status of its individual tenants or support their program eligibility. These areas are discussed below.

Required tenant accounting records were not kept on a formal and current basis

The tenant accounting records kept by the projects did not comply with HUD requirements. The tenant records kept by the projects were on a cash basis and primarily only recorded payments by the projects' tenants. The projects' tenant records did not provide for the accrual of monthly rental charges and other tenant charges. Amounts due from individual tenants could not be readily identified and were based on informal records kept at the project.

The official tenant records were maintained at the Management Agent's central office by the Management Agent bookkeeper. The bookkeeper has not maintained the tenant records on a current basis. At the time of our review, the records were not posted current with some not having been posted or updated for over seventeen months. At the time of our review in May 2001, the Management Agent bookkeeper had not posted tenant transactions to tenant subsidiary records since December 1999 for the projects Denver Northeast Apartments and Mitchell 66 Apartments and since June 2000 for Rotella Park Manor.

The long delay in recording tenant transactions prevents the Management Agent, as well as the project owners, from having any meaningful information with which to monitor and administer its HUD subsidized projects. The tenant accounting records, when brought current, only supported entries to the projects' general ledger and were not used to monitor and control the amounts due from tenants at the individual projects.

Tenant security deposit transactions not fully documented or processed timely

At the time of our review, the required subsidiary ledgers for the tenant security deposit transactions were not maintained. Instead, informal records were maintained at the projects that primarily reflected security deposit collections. The accounting for the disposition of security deposit accounts when a tenant vacated from a dwelling unit was not always fully documented or processed in a timely manner.

Information relating to a vacating tenant is furnished by the projects to the Management Agent bookkeeper. Then, as applicable, the bookkeeper processed the security deposit refund. The bookkeeper also identified and recorded the appropriate accounting entries for the vacating tenant to the projects' books of account.

However, the processing of tenant security deposits was not performed in a timely manner. At the time of our review, the security deposit refunds for several vacated tenants had not been processed; some of them up to six or months after the tenant had vacated the project unit. The impact is that vacating tenants who may be entitled to a security deposit refund are not refunded their deposit timely.

Without a subsidiary ledger, the Management Agent is unable to readily identify what their total security deposit escrow account balance should be at any given point in time or what security deposits of vacating tenants have not been properly processed. Furthermore, the absence of such records also hampers the Management Agent from processing any claim against a vacated tenant who may owe money to the projects in excess of their tenant security deposit amount.

Deficiencies noted in the implementation and enforcement of tenant selection and occupancy requirements

The HUD Regulatory Agreements and Housing Assistance Payments Contracts for the three projects, Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor, set out the program requirements governing eligibility of tenants for admission to dwelling units and the conditions of continued occupancy. Accordingly, Mitchell Management has formulated written policies and procedures that detail the tenant selection and occupancy requirements. However, we have identified deficiencies in the implementation and enforcement of these requirements for the two projects, Denver Northeast Apartments and Mitchell 66 Apartments.

Lack of sufficient documentation to support tenant eligibility

We identified deficiencies in the implementation and enforcement of the tenant selection procedures. In order to verify tenant eligibility, the Owner/Management Agent is required to verify information about tenants, and either place copies of the documents, or a list of the documents and information on them, in the tenants file. The tenant files did not always contain documentation to support tenant eligibility.

Of the eight tenant files we reviewed, that are maintained at the Denver Northeast/Mitchell 66 Apartments' leasing office, six of the tenant files did not contain documentation verifying that the tenant met the eligibility requirements. Two of the deficient files were for Denver Northeast Apartments tenants and four were for Mitchell 66 Apartments tenants. The following are the types of documentation that were not located in the tenant files:

- Income verifications;
- Proof of social security numbers (i.e. social security cards or other equivalent proof) for applicable members of the family;
- Background check; and
- Credit/eviction check.

Without proper documentation to support tenant eligibility, the Management Agent lacks assurance that the tenants are in fact eligible and the amount of tenant rent is accurate. The lack of documentation being maintained in the tenant files is a result of the project staff not implementing and the Management Agent not enforcing the tenant eligibility policies and procedures.

Annual certifications not performed timely

The required annual certifications were not always being performed in a timely manner. Of the eight tenant files maintained at the Denver Northeast and Mitchell 66 Apartments' leasing office that we reviewed, four of the tenant files showed that the annual recertification were not completed timely. Additionally, five of the tenants were not notified of the rent charges resulting from the recertification prior to the effective date of the rent change. As evidenced by the tenants' signatures

on the lease amendments, these tenants were notified of the new rent charge after the effective date of the rent change.

The late completion of the tenant recertifications delay the tenants from paying the correct rent based upon their income in accordance with HUD requirements. This situation, in our opinion, stems from the lack of an effective tracking and follow-up system by the project office staff to monitor and ensure that the recertifications are performed timely and the applicable tenant rents are corrected and adjusted as needed.

Inaccurate contract rents being used

The contract rents, and therefore the tenant assistance payments, that were documented in the tenant files for Denver Northeast Apartments were inaccurate. The onsite project staff was not utilizing the most current HUD approved rent schedule. Therefore, the Housing Assistance Payment Vouchers requesting the tenant assistance payments, submitted to the contractor administrator, Colorado Housing and Finance Authority, were not correct.

Because of the incorrect approved rent schedule being used on the monthly Housing Assistance Payment Voucher, the Colorado Housing and Finance Authority has had to adjust the monthly voucher to reflect the correct assistance payment based on the approved Contract Rent amounts. This had to be done before the voucher could be submitted to HUD for payment. Had the Contract Rent amounts not been adjusted each month, HUD would have paid the incorrect Section 8 Housing Assistance payment to the project.

This situation has occurred because the onsite project staff has not received a copy of the most current HUD approved rent schedule. The Management Agent is responsible to provide their staff with the most current approved rent schedule. It is also the Management Agent's responsibility to ensure that the Housing Assistance Payments Vouchers submitted are true and current, and all of the amounts are calculated in accordance with HUD requirements.

Ineffective Management Agent oversight

Overall, the deficiencies discussed above point out the need for improved oversight and direction of the accounting and leasing activities of these HUD insured projects. The primary responsibility for oversight of the projects' activities relating to its tenants' activities rests with the Management Agent, Mitchell Management.

The Management Agent has assigned the responsibility for the accounting of the tenant related activities to its Management Agent bookkeeper. The bookkeeper has been unable to maintain the required tenant accounting records in a timely manner and in conformity with HUD requirements. As a result, the projects'

on-site staff have not had detailed and timely tenant accounting information to properly administer their functions with the projects' tenants.

The Management Agent has not provided sufficient oversight and monitoring of its on-site project staff for the Mitchell 66 and Denver Northeast projects to ensure that all of the required policies and procedures relating to its tenant leasing and occupancy activities are being followed.

Recommendations

We recommend that the Denver Multifamily HUB:

- 2A Require the project owners for the three projects to establish and properly maintain the required tenants accounts receivable and security deposit subsidiary ledgers. The owners should take the necessary steps to ensure that the subsidiary ledgers are maintained on an accrual basis and posted timely. In addition, the disposition of the tenants' security deposit balances for vacated tenants should be processed in a timely manner.
- 2B Require the project owners for the Mitchell 66 and Denver Northeast projects to provide the necessary guidance and action to ensure that the tenant eligibility and continued occupancy requirements are properly documented in the project files.
- 2C Require the project owner for Denver Northeast Apartments project to provide the on-site staff with the correct contract rents and to ensure that the monthly Housing Assistance Payment Voucher is properly completed before it is sent to the Colorado Housing and Finance Authority for processing.
- 2D Provide the necessary guidance and assistance to the project owners in implementing the recommendations above and once the recommendations have been implemented, review the corrective action to ensure that they are being properly maintained and are within HUD requirements.

Finding 3

Books and Accounts Not Maintained in Accordance with HUD Requirements

The books and accounts being maintained by the Management Agent, Mitchell Management, for the three projects, Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor, were not being kept in accordance with HUD requirements. The books and accounts for these projects did not contain all of the required records and were not complete and accurate. More specifically, the following deficiencies were noted:

- Accounting records were not kept current;
- Informal subsidiary ledgers were kept for tenants' accounts receivable and for security deposits;
- Subsidiary ledgers for accounts payable were not kept;
- Inaccurate allocation of costs between projects; and
- Required independent audit reports were submitted late.

The Management Agent has not ensured that the HUD required accounting records have been established and maintained for the three projects. Furthermore, the accounting responsibilities for the three HUD insured projects have been vested with the Management Agent bookkeeper that has been unable to post and maintain the records in a timely manner.

As a result, the Management Agent has had limited financial information with which to administer and monitor its HUD insured projects. In addition, without current financial information, the Management Agent has been unable to ensure that its project funds are being properly and effectively used for project activities.

HUD prescribed books of account are to be maintained in an accurate and timely manner

The Regulatory Agreements and HUD Housing Assistance Payments Contracts with the three projects require that the accounting books of account for the projects to be maintained in conformity with HUD requirements. The Management Agreements between the projects and the projects' Management Agent, Mitchell Management, also contain similar requirements for maintaining the books of account in accordance with HUD requirements. The Management Agreements state that the management agent will establish and maintain a comprehensive system of records, books, and accounts in a manner conforming to the directives of the Secretary, and otherwise satisfactory to the Owner.

HUD requirements for maintaining the projects' books of account are detailed in HUD handbooks. The accounting records are to be kept in accordance with generally accepted accounting principles that require double entry, accrual accounting and the preparation of full financial statements. Furthermore, the records are to be kept on an accurate and timely basis.

The books and accounts are not maintained in accordance with HUD requirements

The books and accounts for the three projects were not maintained in accordance with HUD requirements. More specifically:

- Accounting records were not kept current;
- Informal subsidiary ledgers were kept for tenants' accounts receivable and for security deposits;
- Subsidiary ledgers for accounts payable were not kept;
- Inaccurate allocation of costs between projects; and
- Required independent audit reports were submitted late.

These are discussed below:

Accounting records are not kept current

At the beginning of the audit, the Management Agent informed us that the books were not current. All of the entries to update the General Ledger, including the monthly postings, had not been entered. For example, the records that the Management Agent uses to track tenants' accounts receivable and security deposits had not been prepared in several months. As of the completion of our site work in May 2001, the Management Agent had not prepared these records for the projects Denver Northeast Apartments or Mitchell 66 Apartments since December 1999, and not since June 2000, for Rotella Park Manor. As a result, the entries in the projects' general ledger were not posted current. With incomplete and non-current financial records, the Management Agent is severely hampered in being able to properly administer its projects.

Required subsidiary ledgers for tenant's accounts receivable and security deposits were not established

For the three projects, the Management Agent has not established the required tenant accounts receivable and tenant security deposit subsidiary ledgers that are posted and maintained on an accrual basis and in a timely manner. The tenant records kept by the projects were on a cash basis and primarily only recorded payments by its tenants. The Management Agent bookkeeper maintains the official tenant records for the projects, however these records were not maintained on a current basis. In fact, these records had not been posted for up to ten months. In addition, the tenant records kept by the Management Agent bookkeepers were used only to support accounting entries to the projects' general ledger and were not to supplement the daily occupancy operations at the projects. As a result, the Management Agent and its project staff are unable to readily identify the balance due from any of its tenants. Any determination of a tenant accounts receivable balance can only be obtained by utilizing informal records kept at the on-site project office. This item is discussed in further detail in Finding 2.

The Management Agent has not established and maintained the required tenant security deposit subsidiary ledgers in conformity with HUD requirements or in a timely manner. In addition, the Management Agent was not processing security deposit refunds for its vacated tenants in a timely manner. More specifically, the security deposit refunds had not been processed for some tenants even though the tenants had vacated their units up to ten or more months prior. This item is discussed in further detail in Finding 2.

No subsidiary ledger for accounts payable

Subsidiary ledgers were not being maintained for the projects' accounts payable accounts. Entries in connection with the accounts payable accounts had not been posted timely. As a result, the Management Agent was unable to identify the exact composition and balance of the accounts payable accounts.

The Financial Operations and Accounting Procedures for Insured Multifamily Projects Handbook details how the accounts payable account is to be maintained. Basically, the account is used to accumulate the amount of bills and/or invoices received by the project that are to be paid. Once a payment is made by the project for the bills and/or invoices, the account is to be reduced by the payment amount. The account is to be supported by a subsidiary ledger detailing the composition of the accounts payable balance.

The Management Agreements for the three projects provide guidance concerning information that the Owner should receive on a monthly basis. According to the Management Agreement, the Agent is to furnish the Owner with a schedule of accounts payable by the tenth of each month.

At the time of our review, the Management Agent bookkeeper was not posting the projects' invoices and related payments on a timely basis. Furthermore, in some instances, account payable entries that were made were inaccurate or posted to the wrong account. Instead of recording invoices or bills and subsequent payments to the accounts payable account, some entries were made directly to the expense accounts. For example, a payment was charged directly to the expense account rather than to the accounts payable account. The net result was that the expense was overcharged and accounts payable was overstated.

We noted that since the accounts were not posted on a current basis entries were sometimes posted to the wrong fiscal year. For example, the Denver Northeast Apartment project's 1999 Health Insurance Expense was recorded as an expense to the 2000 fiscal year books of account instead of being expensed to the 1999 fiscal year records. This resulted in the insurance expense being understated on the 1999 fiscal year records and overstated on the 2000 accounting records. This error in our

opinion occurred because the accounting records are not being posted currently. In addition, the lack of a subsidiary ledger being used for the accounts payable accounts for the projects' records ultimately makes it difficult for the Management Agent to know what accurate amount of debt is owed.

Inaccurate allocation of costs between the projects

When allocating costs between projects, the bookkeeping typically was not timely, complete, and/or accurate. The shared expenses were not split or prorated between the projects and posted to the books on a monthly basis. For example, the prorated health insurance expense for more than one project was typically posted in lump sum amounts to the books of account at the end of the year. Our analysis of the recorded expenses showed that transactions were not entered correctly, both in terms of amounts and in terms of debits and credits.

In addition, all of the shared expenses were not being prorated between the applicable projects. For example, the Public Service Company utility expenses for the leasing office of the Denver Northeast Apartments and Mitchell 66 Apartments projects were not being allocated between the two projects. Instead, all of the expense was being charged to Mitchell 66 Apartments books of account. As a result, the Mitchell 66 Apartments project is paying for the expenses of another project, contrary to the provisions of the Regulatory Agreement.

Normally, the amount shown as due from or the receivable on the books of one project should agree with a corresponding amount, a payable, on the other project's books of account. At the time of our review the accounts payable on Denver Northeast project's books did not match the accounts receivable on Mitchell 66 project's books. Our analysis of the differences between the accounts revealed that the shared expenses for the two projects were not being reported accurately on both of the projects' books.

Annual independent audit reports not performed timely

Under the terms of the Regulatory Agreements and Housing Assistance Payments Contracts for the three projects, an independent audit of the projects' books of account is to be performed on an annual basis. The audited financial reports are to be submitted to HUD electronically within the time periods specified by HUD.

The required audited financial reports have not been timely conducted and submitted to HUD. The 1998 Financial Statements for the three projects were not submitted to HUD by the deadline date of August 31, 1999. HUD electronically received the 1998 Financial Statements for:

- Denver Northeast Project on October 6, 1999;
- Mitchell 66 Apartments on September 24, 1999; and

- Rotella Park Manor on October 8, 1999.

These 1998 Financial Statements were all received after the due date of August 31, 1999, twenty-four to thirty-eight days late.

For the following fiscal year, fiscal year 1999, the audited financial statements for the Denver Northeast Apartments and Mitchell 66 Apartments projects were submitted from nine months to over a year late to HUD. The audit reports due HUD by April 1, 2000-were received for:

- Denver Northeast project on April 27, 2001 and
- Mitchell 66 Apartments project on January 7, 2001.

At the time of our site work in May 2001, the Rotella Park Manor Audited Financial Statements for 1999 had not been submitted to HUD.

One of the reasons that the annual audits could not be performed was that the projects' books of account were not being posted and maintained in a timely manner. The required audits could not be performed until after all of the projects' accounting entries had been posted. At the time of our site review in May 2001, the accounting records in many instances had not been posted for the 2000 fiscal year.

Limited financial information available to administer and monitor its projects

Overall, the books and accounts for the three projects have not been maintained in accordance with HUD requirements. In addition, the accounting records have not been posted and kept in a timely and accurate manner. As a result, the Management Agent, Mitchell Management, has had limited financial information with which to administer and monitor its HUD insured projects. In addition, without current financial information, the Management Agent is unable to ensure that its project funds are being properly and effectively used for project activities.

Mitchell Management, as management agent for the three HUD insured projects, has not implemented nor fully maintained the required accounting books of account for the three projects. All of the accounting functions have been assigned and/or undertaken by the Mitchell Management bookkeeper. The bookkeeper, which maintains the accounting records for other non-HUD funded projects and activities, has been unable to maintain the HUD projects' books of account in a timely and accurate manner.

Recommendations

We recommend that the Denver Multifamily HUB:

- 3A Require the project owners to have the Management Agent establish the HUD required books of account for the three projects and to maintain the books in a timely and accurate manner. If the management agent is unable or unwilling to maintain the projects' records in the required manner, then require the project owners to obtain a different qualified management agent to administer the projects.
- 3B Provide the projects' Owners with the necessary technical assistance to establish the minimum required books and accounts.
- 3C Require the projects' owners to take the necessary action to have the required annual independent audit performed and submitted to HUD for those fiscal years where audit reports have not been prepared and submitted to HUD.
- 3D. After the recommendations 3A and 3B have been implemented, review the established books of account for the three projects and ensure that the project records are being maintained in conformity with HUD requirements and in a timely and accurate manner.

Finding 4

Improved Controls Needed Over Cash Receipts

The Management Agent needs to improve its management controls over cash receipts to ensure that all cash collections are properly collected, deposited, and recorded in the projects' books of account. Laundry income for Denver Northeast Apartments and Mitchell 66 Apartments was received and held for up to twelve months before being deposited. All of the functions of receiving and recording the laundry revenues were vested in the Management Agent Bookkeeper who also recorded such transactions on the projects' books of account. This procedure negates the basic internal control component that the handling of cash assets be separate and apart from the recording of such asset transactions on the books of account. Procedures can also be improved to ensure that rental receipts are promptly deposited in accordance with HUD requirements and with the policy that has been established by the Management Agents for its projects.

Delaying the deposit of program receipts not only increases the possibility for such monies to be misplaced or even misused but also prevents the monies from being used by the projects for needed operating activities. Also, the proper separation of duties for handling and recording cash receipts helps to improve the integrity of the projects' cash management system and its related staff members.

Adequate cash receipt controls and timely deposits are to be made

The Regulatory Agreements and Housing Assistance Payments Contracts between HUD and the three projects, Rotella Park Associates, Denver Northeast Associates, and Mitchell 66 Associates, state that the owner is obligated to comply with the HUD Regulations and requirements. These requirements are delineated in various HUD Handbooks.

The Financial Operations and Accounting Procedures for Insured Multifamily Projects Handbook details the cash management controls to be implemented by the project owner and specifies that the project owners are to maintain effective controls and accountability over its cash.

The Financial Operations and Accounting Procedures for Insured Multifamily Projects Handbook requires that persons making up deposits shall not handle the accounts receivable or the general ledger. The same Handbook states that as far as possible, all cash collections should be deposited on the day received. This same requirement is made in the Regulatory Agreements between HUD and the projects whereby monies received for the projects are to be deposited immediately into the project accounts.

The management agent, Mitchell Management, has established its own requirement for the three projects whereby rent receipts are to be deposited once they reach a \$500 threshold.

Lack of effective controls over cash receipts

The Management Agent has failed to maintain effective controls and accountability over its cash receipts. Our review found that:

- Laundry income for two projects, Denver Northeast Apartments and Mitchell 66 Apartments, is not deposited timely and the key functions of receiving, recording, and depositing such revenue is vested in the same management agent employee; and
- Deposits of cash receipts from tenants for all three of the Mitchell Management projects are not being made timely.

Deficient controls over project laundry revenues

Our review identified that laundry income for Denver Northeast Apartments and Mitchell 66 Apartments was allowed to accumulate for up to twelve months before the monies were deposited. More specifically, laundry income received by Mitchell Management from April 1, 2000 through February 28, 2001 was not deposited into the operating accounts of Denver Northeast Apartments and Mitchell 66 Apartments until March 28, 2001. Laundry income held for Denver Northeast Apartments during this time totaled \$318.05, while the laundry income held for Mitchell 66 Apartments totaled \$698.88.

This situation occurred because laundry income for these two projects was sent directly to the Bookkeeper of the Management Agent. The Bookkeeper explained that the monies were kept until such time as the Bookkeeper could get a deposit slip from the projects in order to make the deposits into the project's bank account. Only after our inquiry and request were the monies deposited by the Bookkeeper.

This practice by the Bookkeeper deviates from HUD's timely deposit of project revenues requirement, as well as, places the monies in jeopardy of possibly being lost or stolen. In addition, the handling of project monies by the Bookkeeper, who also deposits and records such revenues to the project's official books of account, allows all key functions to be vested in the same individual. A proper control system over cash receipts would be for the functions of handling cash to be separate from the functions of recording the cash receipt transaction on the accounting records.

Laundry revenues for the Rotella Park Manor project are received directly at the project site office and deposited by the site staff into the project's bank account. This same practice is needed for the laundry receipts for the Denver Northeast and Mitchell 66 projects. Laundry revenues for these two projects should be received directly by the projects' site office and deposited by the site administrative staff. This would allow the monies to be deposited timely and to separate the functions of

handling monies from the accounting functions maintained by the management agent Bookkeeper.

Timeliness of rental income deposits needed

During the audit period, the Management Agent did not ensure that rental income was deposited timely as required for its three projects, Rotella Park Manor, Denver Northeast Apartments, and Mitchell 66 Apartments. Details follow.

Rotella Park Manor

For the time period of October 1, 2000 through December 31, 2000, Rotella Park Manor made eleven deposits into its operating account. Monies were held anywhere from two to twenty days before deposits were made. More specifically:

- Four of the eleven deposits were held from five to ten days before the monies were deposited.
- Four of the eleven deposits were held for over ten days before the monies were deposited. The amounts of these four deposits ranged from \$2,335 to \$3,554.
- For one of the four deposits held over ten days, the monies were collected between November 1, 2000 and November 3, 2000; however, the deposit of \$2,790 was not made until November 21, 2000. The amount of the deposit was \$2,790.

Denver Northeast Apartments

For the time period of October 1, 2000 through December 31, 2000, Denver Northeast Apartments made nine deposits into its operating account. Monies were held anywhere from one to twelve days before deposits were made. More specifically:

- Two of the nine deposits were held from five to ten days before the monies were deposited.
- One of the nine deposits was held for 12 days before the monies were deposited.

Mitchell 66 Apartments

For the time period of October 1, 2000 through December 31, 2000, Mitchell 66 Apartments made twenty deposits into its operating account. Nine of these twenty deposits were held from five to ten days before the monies were deposited.

Failure to comply with HUD requirements

These two areas discussed above illustrate that the projects are not depositing their monies timely. Not only does this deviate from HUD's requirements but also from the policy that has been

set by Mitchell Management whereby monies that reach the threshold of \$500 are to be promptly deposited.

Retaining program monies for a period of time, such as up to twelve months, increases the possibility for the funds to be misplaced or even misused. Delays in making timely deposits prevent the monies from being used by the projects for needed operating activities. In addition, the separation of duties of handling program monies from the functions of recording such receipts in the accounting records helps to improve the integrity of the projects' cash management system and its related staff members.

Recommendations

We recommend that the Denver Multifamily HUB:

- 4A. Require the Management Agent to implement necessary procedures to ensure that project revenues are timely deposited into the appropriate project's bank account and to provide for the separation of the duties of handling laundry receipts from the duties of recording such revenues on the books of account by the Management Agent Bookkeeper, and
- 4B. Review and evaluate the procedural changes for compliance with HUD requirements after the procedural changes have been made under item 4A above.

Management Controls

In planning and performing our audit, we obtained an understanding of Mitchell Management's management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include systems for measuring, reporting, and monitoring program performance.

Management controls assessed

We determined the following management controls were relevant to our audit objectives:

- Accounting books and records;
- Cash management;
- Procurement and contract administration;
- Capital improvements and maintenance;
- Compliance with HUD tenant eligibility requirements;
- Segregation of duties;
- Proper execution of transactions and events;
- Accurate and timely recording of transactions and events; and
- Ensure that the findings of audits and other reviews are promptly resolved.

Assessment procedures

The following audit procedures were used to evaluate the management controls.

- Interviews with Management Agent and projects staff;
- Review of maintenance actives and related records;
- Review of the cash disbursement records and files related to the eligibility and use of HUD program funds;
- Review of cash receiving, depositing, and recording records;
- Review of the maintenance of the books and accounts;
- Review of tenant eligibility and occupancy policies and procedures;
- Interviews with HUD Office of Multifamily HUB program officials and review of applicable HUD records and files;
- Interviews with Colorado Housing and Finance Authority officials, and review of pertinent Authority records.

Significant Weaknesses

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

Our audit identified the following significant weaknesses:

- The projects are not being maintained in a decent, safe, and sanitary condition;
- Vacant units are not timely rehabilitated and ready for occupancy in a reasonable length of time (loss of revenue);
- Tenant are not always charged for tenant caused damages (loss of revenue);
- Required annual and move-out physical inspections are not always being performed and/or documented;
- Required reserve for replacement deposits are not being made for one of the projects;
- The established tenant eligibility and occupancy policies and procedures are not consistently being implemented, nor enforced;
- Books and accounts are not complete, nor accurate.
- Effective controls and accountability over cash receipts are not being maintained.

These deficiencies are discussed in the Findings section of the report.

Follow-up on Prior Audits

The HUD Office of Inspector General for Audit previously performed a limited review of Rotella Park Manor Apartments. A memorandum was issued on October 19, 1998 and explained that the preliminary review had not indicated any instances of fund misappropriation. At that point, there were three Management Improvement Operation Plan deficiencies, which had not been completed. The Colorado Housing and Finance Authority were to continue to monitor and require completion of the items.

There has not been any HUD Office of Inspector General for Audit reviews or audits of the operation and/or management of Denver Northeast Apartments and Mitchell 66 Apartments.

This is the first HUD Office of Inspector General for Audit review of the activities of the management agent, Mitchell Management.

During our audit period, there were no Management Reviews performed by HUD for Denver Northeast Apartments and Mitchell 66 Apartments. However, HUD performed a Comprehensive Management Review of Rotella Park Manor on March 11, 1999. The overall rating of the review was unsatisfactory because of the numerous contractual violations. The contracts that were violated by the Owner include the Regulatory Agreement, HAP Contract, and Management Certification. The unsatisfactory rating was based on three major categories of findings: Maintenance and Security, Financial Management, and General Management Practices.

The Colorado Housing and Finance Authority completed Management Reviews and Physical Inspections of Denver Northeast Apartments on September 20, 1999, and November 27, 2000. Both management reviews resulted in an overall rating of satisfactory for management operations. However, the Physical Inspection reviews noted deficiencies. The November 2000 review identified items that required immediate attention, including smoke detectors, broken windows, and inoperable furnaces.

During our review of Mitchell Management, including the three projects, Denver Northeast Apartments, Mitchell 66 Apartments, and Rotella Park Manor Apartments, we found most of these same conditions still exist. Although, HUD did not perform a management review of the Denver Northeast Apartments or Mitchell 66 and the Colorado Housing and Finance Authority's management review was satisfactory, we identified deficiencies in the management and operations of these two properties that were similar to the deficiencies HUD noted during their review of Rotella Park Manor. The introduction section of the report explains the prior HUD reviews in more detail, and the finding section of the report explains our results in more detail.

As of the end of our site work, May 2001, the latest audits performed of the three projects by an independent public accountant were for the 1999 fiscal year. The results of the audits are summarized by project.

Denver Northeast Apartments

The audit report contained a finding that the project was not properly documenting the move-in/move-out inspections. The auditor recommended that procedures be performed to assure that the forms were properly completed upon occupancy.

Mitchell 66 Apartments

The audit report contained findings dealing with the lack of evidence in many cases supporting that tenant social security numbers were verified and that move-in/move-out inspection forms were not being fully completed or documented. The auditor recommended that procedures be implemented to correct these deficiencies.

Rotella Park Manor

The 1999 audit report contained three findings. The first finding stated that the project kept the tenant security deposits in an interest bearing account, however, the accrued interest earned was not being paid when the security deposits were refunded. The second finding pointed out that the project had not made the required monthly deposit of \$8,100 for a three month period into the restricted "Management Improvement and Operating" plan escrow account, leaving a shortfall of \$24,300. The third finding stated that the project had not been making the necessary monthly deposits into the Reserve for Replacement escrow account. The reason given for not making the deposits was that the project had encountered cash flow problems.

Our review disclosed that for the most part these same conditions still existed at the time of our review. These items are discussed in detail in the Findings section of this report.

Appendices

Appendix 1

Auditee Comments

MITCHELL MANAGEMENT
2001 YORK STREET
DENVER, COLORADO 80205
303.388.4314 / 303.388.8506 (FAX)

March 14, 2002

Mr. Ernest Kite
Assistant District Inspector
Office of Inspector General
U. S. Department of Housing & Urban Development
633 17th Street 14th Floor
Denver, Colorado

RE: Draft Audit Report
Mitchell Management
Denver, Colorado

Dear Mr. Kite

The purpose of this letter is to acknowledge the receipt of the draft copy of the Inspector General's report and to state that a formal response will be submitted after the final audit report is issued.

We are aware of the items of concern contained in your report, and have instituted corrective procedures to correct all deficiencies. The addition of a professional accountant has corrected all financial reporting deficiencies, and helped to insure the timeliness of record keeping and financial reporting. Both Denver Northeast and Mitchell 66 were current as of 12-31-01, and have submitted their year end financial statements for audit by our outside auditors. Rotella Park is in the final stage of completion.

Status of the projects is as follows:

Denver Northeast

- *Occupancy is at 100%.*
- *Financial statements for year ending 12-31-01 are in the process of being audited.*
- *MIO plan has been developed and submitted to HUD for review and consideration, addressing all maintenance and repairs indicated.*
- *On site management team is being closely monitored in areas of deficiencies.*

MITCHELL MANAGEMENT

March 14, 2002
Mr. Ernest Kite
Page 2

Mitchell 66

- *Financial statements for year ending 12-31-01 are in the process of being audited.*
- *Vacancies are being rehabilitated as funds become available.*
- *Mitchell 66 Apartment is currently under contract for sale to local non-profit housing group, (Northeast Denver Housing Center). Project will be refinanced and MIO plan completed by new owner.*

Rotella Park

- *Financial statements for the year ending 12-31-01 are being completed.*
- *Cash flow problems still exist. A request has been made for the abatement of mortgage payments for 60-90 days to provide funds for renovating vacant units and increasing occupancy.*
- *Currently we are in the final stage of negotiation for the sale to local Limited Partnership with experience in affordable housing.*

The pending sale of both Mitchell 66 and Rotella Park Manor Apartments to new owners will preserve the housing stock of affordable units, and will enhance the living conditions of the existing residence through extensive renovation of all of the units. In addition, the completion of the proposed MIO plan for Denver Northeast will insure the continued availability of the affordable units provided by this development.

Sincerely

MITCHELL MANAGEMENT



Bertram A. Bruton, Principal

Appendix 2

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