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# AUDIT REPORT



JACK HALL WAIPAHAU,  
WESTLAKE, AND KULANA NANI PROJECTS  
MANAGED BY  
CHANEY, BROOKS AND COMPANY

HONOLULU, HAWAII

2003-LA-1001

July 28, 2003

OFFICE OF AUDIT, REGION IX  
LOS ANGELES, CALIFORNIA

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Issue Date July 28, 2003
Audit Case Number 2003-LA-1001

TO: Janet Browder, Director  
San Francisco Multifamily Hub, 9AHM

*Joan S. Hobbs*

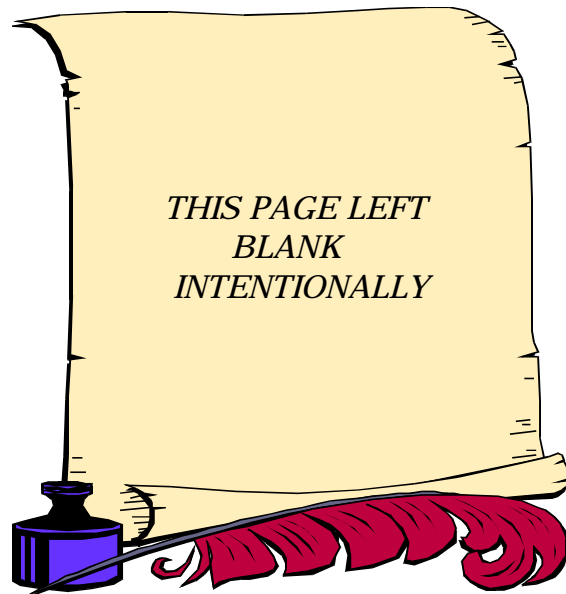
FROM: Joan S. Hobbs  
Regional Inspector General For Audit, 9DGA

SUBJECT: Jack Hall Waipahu, Westlake, and Kulana Nani Projects  
Managed by Chaney, Brooks and Company  
Honolulu, Hawaii

We conducted an audit of Chaney, Brooks and Company. We determined the management agent did not provide adequate oversight of repairs, renovations, and procurement of goods and services for three multifamily properties. However, based on the terms of the Regulatory Agreement, the owner is ultimately responsible. Our report contains one finding addressing these issues with recommendations requiring action by your office.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please give us, for each recommendation in this report, a status report on: (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is considered unnecessary. Additional status reports are required at 90 and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Clyde Granderson, Assistant Regional Inspector General for Audit, at (415) 436-8101 or me at (213) 894-8016.



# Executive Summary

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We reviewed selected areas of Chaney, Brooks and Company's (CBC) records, generally covering the period January 1994 through December 1997. The audit was initiated based on a referral due to specific concerns of the Honolulu HUD Office of Multifamily Housing. When the Fiscal Year 1997 (FY 97) Audited Financial Statement for Jack Hall Waipahu, a HUD-insured and subsidized multifamily property, was issued in January of 2000, the Certified Public Accountant (CPA) issued a disclaimer based on inadequate accounting records for apparent double billings for renovations. The HUD Project Manager, HUD Hawaii State Office, performed a targeted desk management review of Jack Hall Waipahu's financial records. That review showed multiple duplicate and excessive payments to at least two contractors in Oahu, as well as renovations that were paid but not performed. The HUD Project Manager also found payments to the contractors at the Jack Hall Kona project. Since Jack Hall Kona does not have a HUD-approved Regulatory Agreement, we did no further analysis on this project.

Our review objective was to assess the management agent's and owners' performance relating to the oversight of renovation and repair work, and procurement of goods and services, as required by Federal regulations and agreements. We assessed procedures and controls in place during the review period, as well as those currently in place. In addition to the Jack Hall Waipahu project, we reviewed the operations of two additional projects managed by CBC, Waipahu, Westlake and Kulana Nani.

Subsequent to the completion of our review, the owners of Jack Hall Waipahu, Waipahu Jack Hall Memorial Housing, prepaid the HUD-insured mortgage and are no longer bound by the terms of the Regulatory Agreement. However, the owner of the other two projects, the City and County of Honolulu (City), is still required to abide by the Regulatory Agreement terms.

The audit disclosed serious problems in the use of project funds, including a lack of management controls by both the owners and the management agent, which need immediate attention.

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The CBC Property Manager used project funds for unreasonable and unnecessary expenses

The CBC Property Manager did not always use project funds for reasonable and necessary expenses related to the operation of the Jack Hall Waipahu, Westlake, and Kulana Nani projects, in accordance with the Regulatory Agreements, Management Certifications, and HUD Handbook guidelines. Specifically, we noted repeated instances where (1) excessive and duplicate charges were approved for payment, (2) fictitious and/or altered bids and invoices were used to substantiate the selection of a particular company and inflate costs, and (3) contracted renovation work was performed by in-house project maintenance personnel. This was caused by CBC's lack of management controls, including poor oversight of its former property manager. However, the owners are

ultimately responsible for the actions of the management agent.

As a result, the owners allowed the management agent to approve ineligible costs totaling \$402,080 for excessively priced and duplicative goods and services. This was a waste and abuse of the limited resources of the projects.

Auditee Comments

The response to the audit from the City and County of Honolulu is attached as Appendix C. The City states it believes it should not be required to reimburse its HUD-insured projects, Kulana Nani and Westlake, because it was the victim of a collusive fraud scheme. The response also stated that two of its own employees were involved in the fraud scheme, and one participant was successfully prosecuted. The City claimed to be perplexed that HUD is asking for reimbursement for ineligible costs.

Recommendations

The findings include recommendations to avoid recurrence of the above problems. The City and County of Honolulu, owner of Kulana Nani and Westlake, should repay the overcharges and ineligible costs to the projects, and CBC should establish written procedures and management controls to protect properties it manages. Since the owners of Jack Hall Waipahu prepaid their HUD-insured mortgage, no repayment is required.

We had an exit conference with an official from the City and County of Honolulu on March 14, 2003, and the City provided a written response to the draft report, which is included in Appendix C. We made changes to the Draft report so the readers of the Audit Report could more readily identify the ineligible costs associated with the City owned properties, Kulana Nani and Westlake, and distinguish them from the non-City owned property, Jack Hall Waipahu. All three properties were managed by Chaney, Brooks and Company (CBC).

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## **Abbreviations**

<b>BFI</b>	<b>Browning Ferris Industries</b>
<b>CBC</b>	<b>Chaney, Brooks and Company</b>
<b>HUD</b>	<b>U. S. Department of Housing and Urban Development</b>
<b>ILWU</b>	<b>International Longshore and Warehouse Union</b>
<b>OIG</b>	<b>Office of Inspector General</b>



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# Introduction

The owners of the Jack Hall Waipahu, Westlake, and Kulana Nani multifamily properties hired CBC to act as management agent. The major HUD programs affecting the properties are the Section 8 rental assistance program and HUD's mortgage insurance program. Under these programs, HUD subsidized the cost of housing for 143 of 144 units at Jack Hall Waipahu, 95 of 96 at Westlake Apartments, 32 units of 160 at Kulana Nani, and provided mortgage insurance for all three projects' owners. Jack Hall Waipahu was endorsed for insurance under Section 221(d)(3) and Westlake and Kulana Nani were under Sections 221(d)(4) and 236, respectively.

Subsequent to the completion of this review, the owners of Jack Hall Waipahu prepaid the HUD-insured mortgage and are no longer bound by the terms of the Regulatory Agreement; therefore, HUD cannot require repayment of the \$207,265 in excessive and duplicative charges. In order to show the magnitude of CBC's management control problems, the Jack Hall Waipahu examples will remain a part of this report. The City and County of Honolulu still owns Westlake and Kulana Nani and both still have HUD-insured mortgages.

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CBC managed the three HUD multifamily projects

The International Longshore and Warehouse Union (ILWU) built Jack Hall Waipahu, located in Waipahu, Hawaii, as a public service. The property is owned by Waipahu Jack Hall Memorial Housing Corporation. The City and County of Honolulu (City) signed Regulatory Agreements for Westlake Apartments, Honolulu, Hawaii, in 1984 and Kulana Nani, Kaneohe, Hawaii, in 1986.

CBC is a profit-motivated diversified real estate firm, based on the Island of Oahu, and has been in business since 1960. The company handles both commercial and residential properties. As of July 2001, CBC still managed 14 HUD-insured and/or subsidized properties on several of the Hawaiian Islands. CBC managed Jack Hall Waipahu until their termination on November 30, 2000. The new management agent assumed management December 1, 2000. Likewise, on April 1, 1999, the owner of Westlake and Kulana Nani, City, replaced CBC with another management company headquartered on the Island of Hawaii. Subsequently, two different management companies were hired for Westlake and Kulana Nani April 1, 2001.

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Audit Objective

The audit was initiated based on a referral due to the specific concerns of the Honolulu HUD Project Manager. Due to these concerns, and the results of our survey work, our audit

objective was to determine whether CBC and the owners provided adequate oversight of repairs, renovations, and procurement of goods and services, and whether the requirements of the Regulatory Agreement were followed.

Our review initially looked at the repairs, renovations, and procurement of goods and services for Jack Hall Waipahu, which was managed by CBC. We added two additional CBC-managed properties, Westlake Apartments and Kulana Nani, because they had the same Property Manager as Jack Hall Waipahu. The City owns these properties, and according to a May 2, 2003 letter from its Deputy Prosecuting Attorney, a city employee involved in these and other city owned properties fraudulently stole \$5.8 million from the City.

Audit scope and methodology

We performed audit work from May 2001 through March 2002. The audit generally covered the period when renovations began in January 1994 through December 1997, when the CBC Property Manager was replaced. We extended the review, where appropriate, to include other periods. We conducted the audit in accordance with generally accepted government auditing standards.

The primary methodologies for the audit included:

- ✓ Consideration of CBC's management control structure and the assessment of risk.
- ✓ Tests of selected financial activities and transactions.
- ✓ Interviews of various current and prior CBC employees, subsequent management agents' staff, and HUD officials acquainted with the properties, including HUD Office of Inspector General Investigation staff.
- ✓ Interviews of vendors who provided services or bids to perform services for CBC properties.
- ✓ Reviews of documentation relevant to HUD's Multifamily and Section 8 housing programs.
- ✓ Comparison of CBC contracted costs to the costs performed by other vendors.

## The CBC Property Manager Used Project Funds For Unreasonable And Unnecessary Expenses

The CBC Property Manager did not always use project funds for reasonable and necessary expenses related to the operation of the Jack Hall Waipahu, Westlake, and Kulana Nani projects, in accordance with the Regulatory Agreements, Management Certifications, and HUD Handbook guidelines. Specifically, we noted repeated instances where (1) excessive and duplicate charges were approved for payment, (2) fictitious and/or altered bids and invoices were used to substantiate the selection of a particular company and inflate the cost, and (3) contracted renovation work was performed by in-house project maintenance. These problems were caused by CBC and the owner's lack of management controls.

As a result, the management agent approved ineligible costs totaling \$402,080 for excessively priced and duplicate goods and services. This was a waste and abuse of the limited resources of the three projects.

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### Governing requirements and agreements

Multifamily project owners entrust a management agent with the day-to-day operations of the project. Therefore, the owner and HUD must be assured the project will be managed in a prudent, efficient, and cost-effective manner, in accordance with applicable laws, HUD rules, contracts, and procedures.

The owners of HUD insured and/or subsidized properties are required to sign Regulatory Agreements and Management Certifications agreeing to very specific requirements with regard to procurement and payment for services, supplies, or materials. The owners of Jack Hall Waipahu, Westlake, and Kulana Nani signed the Regulatory Agreements in 1978, 1984, and 1986 respectively. The Regulatory Agreements provide that:

“(1) The owners shall not assign, transfer, dispose of, or encumber any personal property of the project, including rents, nor pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs; and

(2) the payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services, supplies or materials.”

The Regulatory Agreement for Kulana Nani is slightly different and reads, “Payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services, supplies, or materials in the area where the services are rendered or the supplies or materials furnished.”

The management agent was hired by the owners to perform day-to-day management operations and agreed in the Management Certifications, to:

- Comply with the project’s Regulatory Agreement.
- Assure all project expenses are reasonable and necessary.
- Exert reasonable effort to maximize project income and take advantage of money-saving techniques.
- Obtain contracts, materials, supplies and services, on terms most advantageous to the project and at costs not in excess of amounts ordinarily paid for such contracts, materials, supplies and services.
- Comply with HUD handbooks, notices, or other policy directives relating to project management.

In addition, HUD Handbook 4381.5, the Management Agent Handbook, paragraph 1.a, states, “While HUD will work with management agents and monitor their performance, the property owner is ultimately responsible for a project’s compliance with HUD regulations and requirements.”

Based on the Regulatory Agreement between HUD and the owners, the owners are ultimately responsible for violations of program requirements. Since the Management Certification is between the owners and the management agent, it is also the owners’ responsibility to pursue action against the management agent for damages caused by the management agent.

HUD Handbook 4370.2, REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, paragraph 2.6.E, states in part, “The request for project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project....”

HUD Handbook 4381.5, The Management Agent Handbook, includes the following guidance:

Paragraph 6.50a states, "When an owner/agent is contracting for goods or services involving project income, an agent is expected to solicit written cost estimates from at least three contractors or suppliers for any contract, ongoing supply, or service which is expected to exceed \$10,000 per year or the threshold established by the HUD Area Office with jurisdiction over the project."

Paragraph 6.50b states, “For any contract, ongoing supply or service estimated to cost less than \$5,000 per year, the agent should solicit verbal or written cost estimates in order to assure that the project is obtaining services, supplies and purchases at the lowest possible cost.”

Although the Handbook does not specifically address contracts or ongoing supply or services between \$5,000 and \$10,000, at the very minimum, verbal or written cost estimates should have been obtained.

CBC’s inadequate property management

The same CBC Property Manager was assigned to manage the Jack Hall Waipahu, Westlake, and Kulana Nani projects. The CBC Property Managers for HUD-insured and/or subsidized properties generally managed on-site management company employees, prepared reports, prepared specifications and solicited bids for goods and services, handled occupancy and tenant issues, and approved invoices for payment. However, based on lax oversight and no written policies and procedures, the projects were not always managed in a prudent, efficient, and cost-effective manner.

During 1995, the CBC Property Manager managed a total of 11 properties. He had almost complete control of the day-to-day operations of these projects. There was little or no separation of duties; therefore, the Property Manager

solicited bids, selected the vendors, monitored the work, received the invoices, certified invoices for payment, and, in some cases, personally delivered the checks to the vendors. According to interviews with on-site employees, the Property Manager kept the Resident Manager out of the financial dealings. A former Resident Manager at one property stated he had nothing to do with any of the financial issues and never knew what was being paid for contracted work.

Due to this autonomy, the CBC Property Manager was able to approve excessive and duplicate payments for goods and services, sometimes using fictitious and/or altered bids and invoices. The CBC Accounting Section did not verify contracted service amounts against the invoices submitted by vendors. In addition, the CBC Property Manager instructed in-house project maintenance staff to assist in performing work included in a contractor's scope of work. The CBC Property Manager was fired for poor performance in March 1998.

Subsequent to the Property Manager being fired, CBC instituted an unwritten policy whereby one Property Manager provided limited oversight over the other Property Managers. However, there was nothing to show the extent to which this change was applied or that it provided a substantive effect to remedy CBC's lack of controls. The following sections describe the unreasonable and unnecessary costs approved by the CBC Property Manager and the lack of oversight by the owners.

The City also subsequently implemented additional controls for the projects it owned. The procedures included Property Management Branch monitoring and control procedures, hiring of additional staff for better separation of duties, and stronger enforcement of regulatory requirements.

In July 2000, the Honolulu Multifamily Program Office completed a targeted desk management review of Jack Hall Waipahu financial records. According to the review, there were questionable and duplicate payments for renovations of units. Based on these and other questioned costs, including inflated and/or duplicate carpet installations, the desk review questioned approximately \$139,000.

CBC did a review of the renovations to confirm HUD's review results, and determined a net of nine unit renovations were billed twice, at a cost of \$4,056 each. CBC then reimbursed only \$36,504 (9 times \$4,056) to the project.

Jack Hall Waipahu renovation costs were excessive and questionable

Our review showed additional ineligible costs for renovations on the Jack Hall Waipahu units that were above and beyond CBC's analysis. We reviewed available CBC tenant files and move-out inspections and determined five additional units were either not renovated or did not require renovation. In addition, in-house project maintenance staff painted 40 units; even though the contractor was paid to do the work. The CBC Property Manager used project funds for unreasonable and unnecessary expenses. As a result, ineligible renovation costs totaled \$54,300, including \$20,280 for units not renovated and/or not requiring renovation and \$34,020 for 40 units painted by in-house maintenance.

In 1994, the CBC Property Manager began to contract for renovation of units at Jack Hall Waipahu. Only two contractors, Integrity Builders and JC Builders, performed the renovations during the Property Manager's tenure. Integrity Builders did renovations during 1994 and JC Builders began in 1995 and performed the renovations through 1997.

Although HUD Handbook 4381.5, paragraph 6.50a requires the management agent to obtain three bids for ongoing supplies or services, there were no documents to show CBC solicited other bids, and there were no contracts for the renovations. JC Builders performed the renovations, but could not be contacted regarding the work performed from 1995 through 1997. However, we were able to contact the former supervisor, who worked for both contractors. He described the renovation work as casual and stated in-house maintenance personnel helped with the renovation work. He described it as a joint effort. The supervisor also stated both he and the CBC Property Manager had problems in tracking which units were actually renovated and paid.

### **Units Not Renovated or Not Requiring Renovation**

During a review of CBC files maintained for Jack Hall Waipahu, documentation was located showing five units, in addition to those identified in the analysis performed by CBC, were not renovated or did not require renovation. The CBC Property Manager approved payment of \$4,056 for each of these units. According to former CBC employees, units were not renovated until after the occupants moved out. However, CBC tenant files show three of these units, 102, 172, and 254, were occupied during the supposed renovation. Also, according to CBC project maintenance records, JC Builders did not perform the renovations for unit 120. In-house maintenance staff performed all renovation work on this unit. In addition, a move-out inspection of unit 206 showed the unit was “clean and ready for occupancy” and there was no work to be done. Based on the review of CBC files, its practice was to annotate whether any additional renovations were to be performed. Therefore, no renovation was required when the tenant vacated the unit. As a result, the renovation costs for the five units were not reasonable and should not have been approved. Thus, the project paid \$20,280 for renovations not performed or not required.

### **Unit Painting and Texturing Performed by In-House Maintenance**

JC Builders’ scope of work included interior painting and texturing in each unit. Based on interviews with former CBC in-house maintenance staff, the CBC Property Manager had Jack Hall Waipahu maintenance staff do all painting and texturing using an airless paint sprayer purchased in January 1996. The CBC Property Manager also instructed maintenance staff to purchase virtually all paint and paint related supplies.

In-house maintenance staff reported it generally required three hours for painting and one to two days for texturing the one and two bedroom units at Jack Hall Waipahu. Therefore, we used 15 hours as a conservative average time required to paint and texture units. Based on the 1996 Current Construction Costs, 33rd annual edition, Saylor Publications, Inc., the wage rate for a general painter, adjusted for Hawaii, would be \$56.70 per hour. At an



average of 15 hours per unit, it would cost approximately \$850.50 per unit for painting and texturing. Our review showed 40 units were painted and textured by in-house project maintenance staff. As a result, the painting and texturing costs for the 40 units were not reasonable and should not have been approved. Thus, the project paid \$34,020 for work performed by in-house maintenance staff rather than by the contractor.

The ineligible renovation costs for Jack Hall Waipahu violate the terms of the Regulatory Agreement, the Management Certification, and HUD Handbook 4370.2, REV-1. Both owners and management agents agree to abide by the Regulatory Agreement, which states payments "... for services, supplies, and materials shall not exceed the amount ordinarily paid for such services, supplies, or materials..." In addition, the management agent in the Management Certification agrees to "... assure that all expenses of the project are reasonable and necessary." HUD Handbook 4370.2, REV-1, paragraph 2.6.E states, "... project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project..." Thus, the project paid for \$54,300 in ineligible renovation costs.

Carpeting installation costs at Jack Hall Waipahu and Westlake were excessive and duplicative

We reviewed CBC files and determined carpeting installation costs were excessively high, duplicative, and ineligible at the Jack Hall Waipahu and Westlake projects. As a result, the projects paid a total of \$101,535 in ineligible costs for the carpeting. Of that amount, \$83,876 was paid by Jack Hall Waipahu, and \$17,659 was paid by Westlake. The CBC Property Manager used project funds for unreasonable and unnecessary expenses. We believe this was due to the lack of oversight by the owners of CBC's Property Management activities, and a lack of proper procurement procedures.

The CBC Property Manager selected Independent Installers to install carpeting at Jack Hall Waipahu and Westlake from early 1994 through most of 1997. There were invoices for both properties showing the carpet type was 26-ounce commercial olefin. The owner and President of Island Flooring, a company which installed carpeting subsequent to the firing of the former CBC Property Manager, confirmed this by examining a carpet sample removed from one of the

units. No contract or bids were available to describe the carpet specifications or establish the cost. This violates the requirement in HUD Handbook 4381.5, The Management Agent Handbook, paragraph 6.50a “to solicit written cost estimates from at least three contractors or suppliers for any contract, ongoing supply or service which is expected to exceed \$10,000 per year....”

Of the \$101,535 of ineligible excessive and duplicative carpeting installation costs, \$85,289 was due to excessive charges. Jack Hall Waipahu paid \$72,436 and City owned Westlake paid \$12,853.

### **Jack Hall Waipahu – Excessive Carpet Installation Costs**

During the period February 1994 through November 1997, Jack Hall Waipahu was invoiced, and the Property Manager approved and paid between \$1,250 and \$1,500 for one-bedroom units, and between \$1,352 and \$1,625 for two-bedroom units. The total amount paid for carpeting for over 80 units at Jack Hall Waipahu between February 1994 and November 1997 was \$143,630.

We contacted two different flooring companies, which subsequently installed the same quality and type of carpeting at Jack Hall Waipahu to determine if the charges during 1994 through 1997 were appropriate. In both cases, the carpet installation charges were far below the amount previously charged.

One of the companies, Island Flooring, installed comparable carpeting at Jack Hall Waipahu as a sub-contractor for approximately two years. The company had maintained the same price for the olefin carpet during that time. A one bedroom unit cost \$626 and a two bedroom unit cost \$789. This included about a 20 percent profit mark-up. According to the owner and President of Island Flooring, the carpeting installed in 1994 should have cost less, since both the carpet and the labor would have been cheaper. He estimated the cost should have been approximately one percent cheaper per year.

In order to determine the ineligible costs for carpeting, we determined the allowable costs for each year beginning in 1994 (Appendix B). In 1994, the allowable cost for a one

bedroom unit was computed as 94 percent of \$626, or \$589, and 94 percent of \$789, or \$742, for a two bedroom unit. We then subtracted the allowable cost from the cost charged by, and paid to, Independent Installers to obtain the ineligible cost. (In some instances, we allowed costs where carpeting was installed more than one time per unit when the amount of time was over one year.)

### **Westlake – Excessive Carpet Installation Costs**

During the period March 1994 through December 1997, Westlake was invoiced, and the Project Manager approved between \$1,450 and \$1,976 per unit for carpet installation. The total amount paid for carpeting at Westlake between March 1994 and December 1997 was \$44,452.

We interviewed the store manager at Wayne's Flooring America. The company has installed the same quality and type of carpeting at Westlake, where all units have two bedrooms. Wayne's Flooring charged \$1,145, which included profit, for carpeting installed in 1998. Therefore, we determined the carpet charges by Independent Installers were excessively priced. According to a company employee, the carpeting installed in 1994 should have cost less, since both the carpet and the labor would have been cheaper. As mentioned above, prices should have been approximately one percent cheaper per year. Therefore, the cost should have been about \$1,100 during 1994. The total calculated ineligible cost for excessively priced carpeting charges totaled \$12,853.

In addition, our review of Jack Hall Waipahu and Westlake showed duplicate carpet installation payments were approved in an unreasonable amount of time for 11 units in the amount of \$16,246. We based this on the fact that there were no maintenance requests or move-out inspection forms in the files. Of the 11 units, eight were approved for Jack Hall Waipahu and three for Westlake. The management agent agreed in the Management Certification to ensure "... all expenses of the project are reasonable and necessary." However, the CBC Property Manager did not ensure the reasonableness and necessity of expenses at Jack Hall Waipahu and Westlake. The ineligible excessive carpet installation costs were \$11,440 for Jack Hall Waipahu and \$4,806 for Westlake.

### **Jack Hall Waipahu – Duplicate Carpet Installation Costs**

The Property Manager approved duplicate carpet installation for the same unit in an unreasonable amount of time. Based on the amounts invoiced, these were complete carpet installation charges. Jack Hall Waipahu unit numbers 135, 119, 261, and 244 had payments approved twice for the same month and year. Unit 135 was in February 1995, units 119 and 261 were in April 1995, and unit 244 was in February 1996. In fact, CBC issued check number JW00635 for both carpeting installations of unit 135 on the same date, February 14, 1995.

Units 257, 162, and 217 had payments approved within a two-month, a three-month, and a four-month period, respectively. In each case, the invoice the unit was originally paid from had multiple units included on the statement. Based on the documents reviewed, the time frame between payments was not reasonable to expect the carpet to be replaced. We therefore disallowed \$9,932 for the payments approved and paid to Independent Installers.

We also found CBC approved a \$1,508 invoice in November 1994 for carpeting unit 807, and paid it from Jack Hall Waipahu project funds. However, the invoice was not applicable to the property since there is no such unit number. The Jack Hall Waipahu unit numbers start at 101 and go through 172 and 201 through 272. However, unit 807 corresponds to the Westlake property where Independent Installers was also installing carpet during the same time. The invoice was mistakenly written for Jack Hall Waipahu rather than Westlake. In that case, this installation would also have been duplicative because Independent Installers invoiced and was paid for a complete carpeting installation of Westlake unit 807 in April 1995, just five months later. Therefore, we also disallowed this charge for \$1,508 as ineligible. The total ineligible cost for duplicate payments totaled \$11,440.

### **Westlake – Duplicate Carpet Installation Costs**

Our review showed duplicate carpet installation payments for three Westlake units where the CBC Property Manager had approved payment twice in an unreasonable amount of

time. Unit 408 had payments approved twice within a two-month period. There were two invoices approved for payment, one in March 1994, and the next one, for \$1,450, in May 1994. Unit 208 had payments approved within a three-month period, and unit 211 had payments approved within an eight-month period. The disallowed duplicate payments were \$1,568 and \$1,788, respectively. In each case, the original paid invoices included payment for multiple units. The time frame between payments was not reasonable to expect the carpet to be replaced. The total ineligible cost for duplicate carpet installation was \$4,806.

The ineligible excessive and duplicative charges for carpet installation at Jack Hall Waipahu and Westlake violate the terms of the Regulatory Agreement, the Management Certification, and HUD Handbook 4370.2, REV-1. Both owners and management agents agreed to abide by the Regulatory Agreement, which states payments "... for services, supplies, and materials shall not exceed the amount ordinarily paid for such services, supplies, or materials..." In addition, the management agent in the Management Certification agrees to "... obtain contracts materials, supplies and services ... on terms most advantageous to the project." HUD Handbook 4370.2, REV-1, paragraph 2.6.E states, "... project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project..." Thus, the Jack Hall Waipahu project paid \$83,876, and Westlake paid \$17,659 in ineligible carpeting installation costs. The Westlake owners, the City, should reimburse the project for the ineligible costs.

Roofing and painting costs for Westlake were excessive

We reviewed CBC files and determined roofing and painting costs were excessive for Westlake. This was caused by altered bids and inflated invoices. The CBC Property Manager used project funds for unreasonable and unnecessary expenses. In addition, proper procurement practices were not followed, in violation of Federal requirements and agreements. As a result, the project paid \$95,212 in ineligible costs.

The CBC Property Manager solicited bids for roofing and exterior painting at Westlake apartments in 1996. Separate bids were obtained for each job. Specialty Pacific Builders was selected to do both jobs. However, at least one of the

losing roofing bids was fictitious and inflated. The owner of Salcedo & Son Roofing Corporation was interviewed and stated he had not submitted a bid for \$114,850. His bid, of approximately \$50,000, had been deliberately altered to an amount in excess of Specialty Pacific Builders' bid. Thus, CBC awarded the contracts to Specialty Pacific Builders.

The owner of Specialty Pacific Builders said her actual bid was \$48,850 for the roofing job, far lower than the altered amount of \$81,250. The owner claimed she was unaware her bids were inflated. She also claimed she did not prepare the invoices paid by CBC. Her sub-contractor bid \$40,250, to which she added \$8,600 profit. The CBC Property Manager actually approved payments totaling \$81,250, which was \$32,400 above the alleged Specialty Pacific Builder bid.

In addition, Specialty Pacific Builders bid \$75,995 for the exterior painting, plus \$3,500 for an approved change order. The sub-contractor received \$66,973 and the remaining \$12,522 was profit. However, the CBC Property Manager actually approved \$121,185 in payments, which was \$41,690 above the alleged Specialty Pacific Builder bid. Since the CBC Property Manager personally handled all project contracting work, as well as financial matters, he would have had knowledge, through discussions with Specialty Pacific Builders, both the roofing and painting bids were fictitious and inflated. However, the Property Manager approved the inflated invoices for payment.

The owner of Specialty Pacific Builders cashed the CBC checks even though she knew the amounts exceeded her bid. She stated she distributed the excess to her company's commissioned salesperson, who claimed to be performing additional work at the property. The owner never confirmed whether this additional work was conducted. However, CBC did not contract for additional work and the Property Manager approved invoices stating the entire inflated cost was for painting and roofing.

In addition, the Specialty Pacific Builders' profit on both jobs was inappropriate and ineligible. No added value was provided to the work by having the building contractor act as intermediary. CBC, as management agent, had a duty to contract at the lowest available cost; therefore, they should have contracted directly with the sub-contractors or other

vendors offering similar prices. In fact, it appears the building contractor was actually used as a pass-through so the inflated portion of the CBC approved payments could be immediately turned into cashiers checks and cash. As a result, we also questioned the profit paid to Specialty Pacific Builders. The profit was \$8,600 for roofing and \$12,522 for painting, or a total of \$21,122.

The excessive charges for roofing and painting performed at Westlake violate the terms of the Regulatory Agreement, the Management Certification, and HUD Handbook 4370.2, REV-1. Both owners and management agents agree to abide by the Regulatory Agreement, which states payments "... for services, supplies, and materials shall not exceed the amount ordinarily paid for such services, supplies, or materials..." In addition, the management agent in the Management Certification agrees to "... obtain contracts materials, supplies and services...on terms most advantageous to the project." HUD Handbook 4370.2, REV-1, paragraph 2.6.E states, "... project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project..." Thus, the owners should reimburse Westlake for \$95,212 in ineligible roofing and painting costs.

Garbage collection costs at the three projects were excessive and ineligible

We reviewed CBC contracting files and determined the CBC Property Manager approved excessive costs for garbage collection services. This occurred due to CBC's lack of procurement procedures and accounting controls, including its failure to verify invoice amounts to the contract amounts, and insufficient monitoring by the owners. As a result, the total excessive charges for garbage collection at the three properties totaled \$68,756. Of this amount, \$38,553 was for Jack Hall Waipahu, \$11,918 was for City owned Westlake, and \$18,285 was for City owned Kulana Nani. Thus, CBC used project funds for unreasonable and unnecessary expenses.

In November 1995, the CBC Property Manager entered into an agreement with The Refuse, Inc., to provide garbage collection services at Jack Hall Waipahu, Westlake, and Kulana Nani. The contract amounts and periods covered differed, but the service for all three properties began December 1, 1995.

Subsequently, in November 1996, National Waste Removal Services, Inc., began invoicing the projects. CBC did not enter into contracts with the new company. Apparently, CBC informally allowed for National Waste Removal Services, Inc. to take over the contract with The Refuse, Inc.

### **Jack Hall Waipahu – Garbage Collection Costs**

The agreed upon charge for garbage collection services was \$1,593 per month. However, the first invoice dated December 15, 1995, was for \$2,396. This was \$803 over the contracted monthly amount. CBC approved and paid project funds for all subsequent invoices for the same inflated amount, without obtaining an explanation for the discrepancies. The total amount ineligible for garbage collection from December 1995 through November 1999 was \$38,553.

There is no evidence CBC took any action to correct the excessive charges until April 1998, when the newly assigned CBC Property Manager attempted to contact The Refuse, Inc. However, by this time, The Refuse, Inc., had not been sending invoices for 18 months, and the new Property Manager was told the company was out of business. Although the management agent agreed in the Management Certification to obtain contracts on terms most advantageous to the project, he did not contact National Waste Removal Services to determine the reason for the variance. Subsequently, the Property Manager approved the excessive costs for garbage collection an additional 19 months, through November 1999. In December 1999, a new company was contracted to provide the service for \$1,137 per month.

### **Westlake – Garbage Collection Costs**

The Refuse, Inc., agreed to charge Westlake approximately \$1,156 per month. However, the invoices were for \$1,454. This was \$298 over the monthly contract amount. This contract ran through March 1999, almost one year after CBC fired the Property Manager. The total excessive charges for 40 months of garbage collection, from December 1995 through March 1999, totaled \$11,918.



### **Kulana Nani – Garbage Collection Costs**

Although garbage collection service for Kulana Nani began December 1, 1995, no documents were available to verify the agreed upon price. We attempted to contact the vendor, but the number was no longer in service. However, we did locate a bid from Browning-Ferris Industries (BFI) of Hawaii, dated November 15, 1995, to perform the project's garbage collection for \$2,109 per month. We used the BFI bid amount for our comparison, since The Refuse, Inc., should have at least matched this bid under normal procurement practices to be selected for the service. The invoices were for \$2,813, or \$703 more than the BFI bid. The contract ran through January 1997. The total excessive charges for garbage collection from December 1995 through December 1997 totaled \$18,285.

The excessive charges for garbage collection at Jack Hall Waipahu, Westlake, and Kulana Nani violates the terms of the Regulatory Agreement, the Management Certification, and HUD Handbook 4370.2, REV-1. Both owners and management agents agree to abide by the Regulatory Agreement, which states payments "... for services, supplies, and materials shall not exceed the amount ordinarily paid for such services, supplies, or materials..." In addition, the management agent in the Management Certification agrees to "... obtain contracts materials, supplies and services ... on terms most advantageous to the project." HUD Handbook 4370.2, REV-1, paragraph 2.6.E states, "... project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project..." Thus, the Jack Hall Waipahu project overpaid \$38,553, and the Westlake and Kulana Nani project owner (City) should reimburse the projects \$11,918 and \$18,285, respectively.

Pest control service costs for the three projects were excessive and ineligible

The CBC Property Manager used several different pest control companies at Jack Hall Waipahu, Westlake and Kulana Nani. We reviewed CBC's contracting files, and found that the CBC Property Manager approved excessive costs for pest control services. The CBC Property Manager used project funds for unreasonable and unnecessary expenses. This occurred because of CBC's lack of monitoring and procurement procedures and controls. As a result, the total excessive charges for pest control at the three

properties totaled \$55,122. Of this amount, \$30,536 was for Jack Hall Waipahu, \$20,130 was for City owned Westlake, and \$4,456 was for City owned Kulana Nani.

### **Jack Hall Waipahu – Pest Control Costs**

The CBC Property Manager contracted with Island Termite, Inc., for roach and ant treatment, and Pest Managing-Hawaii for roach and ant treatment and ground termite treatments between 1994 and 1997. Based on information from the owner of Fumiseal, the company hired in 2000 to treat Jack Hall Waipahu for most of the same pest control services, the costs charged by the prior companies were excessively priced.

In 1994, 1995, and part of 1996, the CBC Property Manager contracted with Island Termite for roach and ant treatment. Island Termite charged approximately \$4,792 per treatment in 1994, and \$5,092 in 1996. During mid-1996 through 1997, CBC used Pest Managing-Hawaii. Pest Managing-Hawaii charged approximately \$4,781 in 1996, and \$5,938 in 1997. The owner of Fumiseal charges less than \$2,500 for the same service. Based on the Fumiseal charges, CBC paid excessive charges of \$11,124 for roach and ant treatment.

During 1995, Island Termite also treated the units at Jack Hall Waipahu for ground termites, and charged \$42,120. This included a 3-year warranty. The Island Termite charges were excessive because the owner of Fumiseal stated he would charge \$25,000 for the same termite treatment. In addition, in 1996, CBC approved over \$1,000 for Pest Managing-Hawaii to do spot termite treatments, although the Island Termite warranty was still in effect and should have been provided by Island Termite at no cost. The total excessive charges for termite treatment totaled \$19,412.

In order to calculate total excessive charges for pest control treatment at Jack Hall Waipahu, we reduced Fumiseal's charges by one percent per year. This was based on the Fumiseal owner stating chemicals, labor, and insurance increased his costs approximately one percent per year. Total ineligible costs for roach and ant and termite treatments was \$30,536.

### **Westlake – Pest Control Costs**

Island Termite and Pest Managing-Hawaii treated Westlake concurrently between February 1994 and January 1997. Pest Managing-Hawaii provided interior roach/ant treatment and Island Termite treated the exterior. The costs of these companies were excessive compared to the company performing the same work in 2001, C.U. Pest Control, and three different pest control bids obtained by a subsequent management agent in 1999.

In addition, there was evidence of deliberately deceptive bids in order for Pest Managing Hawaii to be the lowest bidder. In an interview, the owner of Vet's Termite Control stated he had not submitted the Westlake bid, and he did not use letterhead stationery when he submitted bids. The owner, who was also a former president of the Hawaii Pest Control Association, also questioned whether the owner of Hygienic Termite and Pest Control had signed the other bid, since he had gone out of business approximately seven years before.

CBC contracted for unreasonable pest control services which far exceeded prices available, even in subsequent years. Twice in 1994, and once in 1995, 1996, and 1997, Pest Managing-Hawaii treated the interior of the units. The amounts approved for payment were \$3,812 each time in 1994, \$4,500 in 1995 and 1996, and \$5,400 in 1997. However, Island Dynamic Terminix and Diversified Exterminators submitted bids in 1999, and would have charged \$960. GIMA Pest Control also submitted a bid for \$1,106. As of October 2001, C.U. Pest Control also charged \$960. We calculated total excessive charges for pest control treatment at Westlake by using \$960 as a reasonable cost.

The exterior service, which was done more than quarterly by Island Terminix but less than monthly, was \$291. However, the companies bidding in 1999, Island Dynamic Terminix, Diversified, and GIMA, would have charged \$179, \$200, and \$325 per quarter, respectively. C.U. Pest Control charged \$150 per quarter in October 2001. We used a generous bid amount of \$200 to determine the appropriate rate for exterior service.

The interior and exterior pest control service bids were reduced one percent per year to reflect cheaper chemicals and

labor in the earlier years. The total ineligible costs for pest control treatment at City owned Westlake's 96 units totaled \$20,130.

### **Kulana Nani – Pest Control Costs**

Since 1995, the CBC Property Manager used Pest Managing-Hawaii exclusively at Kulana Nani. We reviewed CBC and the two subsequent management agents' project files to determine whether other pest control companies had provided similar pest control services. Since the CBC Property Manager was fired in 1998, we found only one company, Environ Control, Inc., had bid for roach and ant treatment. Based on that company's 1999 bid for treating roaches and ants, the costs charged by the prior company were excessively priced.

In addition, there was evidence of deliberately deceptive bids in order for Pest Managing-Hawaii to be the lowest bidder for the ground termite treatment in 1996. The same two companies who supposedly bid for roach and ant treatment at Westlake, did not submit bids. Based on an interview with the owner of Vet's Termite Control, the bid was fictitious. The owner of Vet's had stated he never submitted any bids for work at Kulana Nani. The bid by Hygienic Termite and Pest Control was questionable based on the earlier interview of the Vet's Termite Control owner.

Twice in 1994, once in 1995 and 1996, and twice in 1997, the company hired by the CBC Property Manager treated the project for roaches and ants. The amount approved for payment was \$6,670 each time in 1994, \$7,661 in 1995 and 1996, and \$9,193 both times in 1997. However, in 1999, Environ Control would have charged only \$7,520. Since chemicals and labor were cheaper in the earlier years, for each year before 1999, we reduced the cost by one percent. The total ineligible cost for pest control treatment at City owned Kulana Nani's 160 units was conservatively computed to be \$4,456.

The excessive charges for pest control services at Jack Hall Waipahu, Westlake, and Kulana Nani violate the terms of the Regulatory Agreement, the Management Certification, and HUD Handbook 4370.2, REV-1. Both owners and management agents agreed to abide by the Regulatory

Agreement, which states payments "... for services, supplies, and materials shall not exceed the amount ordinarily paid for such services, supplies, or materials..." In addition, the management agent in the Management Certification agrees to "... obtain contracts materials, supplies and services ... on terms most advantageous to the project." HUD Handbook 4370.2, REV-1, paragraph 2.6.E states, "... project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project..." Thus, the Jack Hall Waipahu project overpaid \$30,536; the City, owner of Westlake and Kulana Nani, should repay the respective projects \$20,130 and \$4,456.

Elevator preventative maintenance costs at Kulana Nani were excessive

We reviewed CBC's contracting files and determined the CBC Property Manager approved excessive costs for elevator preventative maintenance services. The CBC Property Manager used project funds for unreasonable and unnecessary expenses. This occurred due to CBC's lack of proper procurement procedures. As a result, the total excessive charges for elevator preventative maintenance between 1996 and 1998 were \$27,155.

Kulana Nani has one elevator in each of its eight buildings. Schindler Elevator has provided preventative maintenance and repair services since 1981. The contract was for a five-year period, and then was automatically renewable for additional five-year terms. The contract included an annual price adjustment, whereby the cost increased annually by a specific factor. The initial contract was for \$1,298 a month; however, by 1998, it had increased to \$2,780 per month.

After the CBC Property Manager was fired in 1998 and replaced by another CBC Property Manager, the new Property Manager contacted the company attorney to cancel the contract due to costs being excessively high. However, the contract clearly states it can only be terminated at the end of each five-year term. The CBC attorney determined the contract could not be terminated in the middle of the contract term.

In 2001, the new management agent was negotiating a new contract. Schindler Elevator, which had been providing service since 1981, had the lowest bid of \$1,543 a month, far below the charge at that time. We believe CBC should have

renegotiated the contract at the end of the prior term. The contract could have been modified at that time, or a new vendor selected to obtain elevator service at a more reasonable rate. Based on the data available from 1996 through 1998, the project could have saved approximately \$27,155. We believe the CBC Property Manager, during 1996, should have sought elevator preventative maintenance services on terms most advantageous to the project.

The excessive charges for elevator preventative maintenance at Kulana Nani violate the terms of the Management Certification and HUD Handbook 4370.2, REV-1. The management agent in the Management Certification agrees to "... obtain contracts materials, supplies and services ... on terms most advantageous to the project." HUD Handbook 4370.2, REV-1, paragraph 2.6.E states, "... project funds should only be used to ... pay reasonable expenses necessary for the operation and maintenance of the project ...." Thus, the owners (City) should reimburse the Kulana Nani project \$27,155.

Summary of ineligible costs by project

In summary, the ineligible costs for Jack Hall Waipahu include \$54,300 for renovations, \$83,876 for carpeting, \$38,533 for garbage collection, and \$30,536 for pest control, for a total of \$207,265. For City-owned Westlake, the ineligible costs are \$17,659 for carpeting, \$95,212 for roofing and painting, \$11,918 for garbage collection, and \$20,130 for pest control, for a total of \$144,919. The ineligible costs for City-owned Kulana Nani include \$18,285 for garbage collection, \$4,456 for pest control, and \$27,155 for elevator preventative maintenance, for a total of \$49,896.

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Auditee Comments

The City's response states ... "The City understands its responsibility as owner; however, we believe the City should not be required to reimburse the Kulana Nani and Westlake projects, as the City was the victim of a collusive fraud scheme during the time period in question."

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OIG Evaluation of Auditee Comments

We agree the City was the victim of collusive fraud; however, we believe the fraud perpetrated was primarily due to a lack of management controls and oversight by the

City. The City had not implemented internal controls in order to preclude managers from having complete control over the operation and management of its HUD-subsidized and/or insured properties. As a result, a City Housing Department Manager was able to independently approve all contracts and payments and the City's management agent, CBC, was virtually free to contract for services at will. Subsequent to the discovery of the collusive fraud it described in its response, the City took action to address the controls which were lacking, i.e., monitoring, management inspections, separation of duties, and enforcement of regulatory agreements.

Not only were HUD-insured developments put at risk due to the massive fraud and bid rigging that occurred, the letter at Attachment A to the response at Appendix C also indicates that \$5.8 million City dollars were stolen by a City employee. Per the letter, the same City employee solicited repair bids for the City-owned Kulana Nani and Westlake properties and, along with co-defendants, fraudulently altered valid bids by inflating bid amounts and submitting lower false bids.

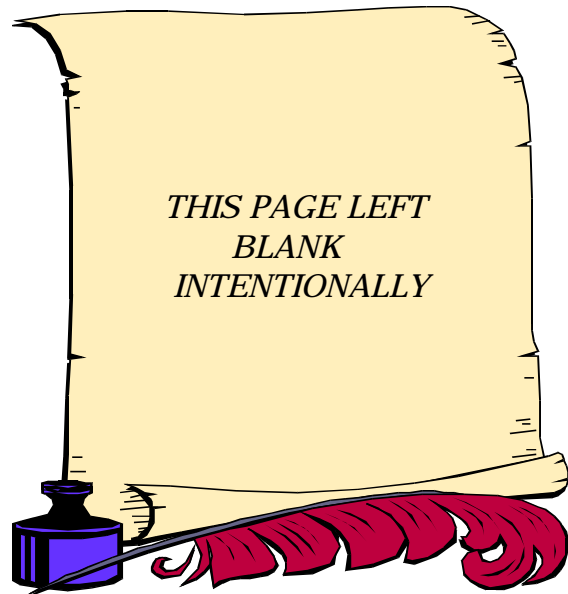
As stated in the Audit Report, the Regulatory Agreements and HUD Handbooks, clearly recognize that the owners are ultimately responsible for violations of program requirements. As such, we look to the owners to repay the HUD-insured properties.

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## Recommendations

We recommend the Director of the San Francisco Multifamily Hub:

- 1A. Require the City and County of Honolulu to repay Westlake \$144,919, and Kulana Nani \$49,896 for excessive and/or duplicate payments approved by the former CBC Property Manager.
- 1B. Impose administrative sanctions against CBC until it demonstrates it has developed and implemented adequate written procedures and controls over its accounting, procurement, on-site manager training, and monitoring responsibilities.





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# Management Controls

In planning and performing our audit, we considered the management controls used by CBC in Jack Hall Waipahu, Westlake, and Kulana Nani operations to determine our auditing procedures, not to provide assurance on the controls. Management controls include the processes affected by an entity's management and other personnel, designed to provide reasonable assurance for achieving objectives for program operations, validity and reliability of data, compliance with applicable laws and regulations, and safeguarding resources.

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## Relevant management controls

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

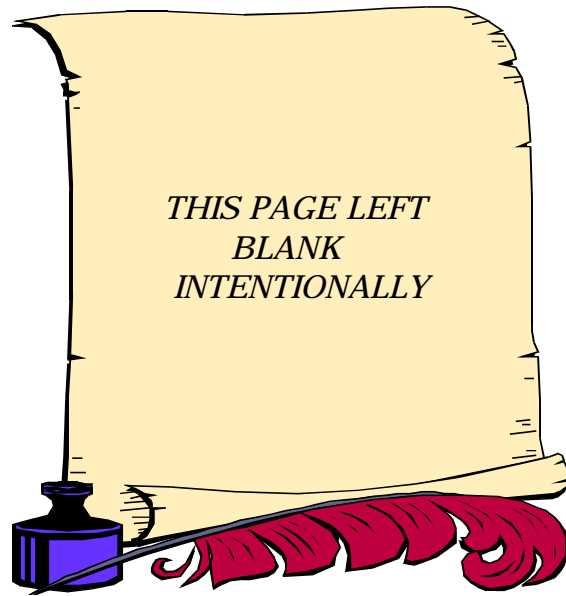
- Procurement controls
- Monitoring and tracking contracted work controls
- Disbursement controls
- Monitoring activities of property manager controls

We obtained an understanding of the control structure for the above systems and determined the risk exposure to design audit procedures. We concluded that the audit would be performed more efficiently by doing substantive tests without relying on management controls.

## Significant weaknesses were identified

A significant weakness exists if a management control does not give reasonable assurance control objectives are met. We observed significant weaknesses with the control processes reviewed. The CBC had no written policies and procedures for property managers to follow regarding procurement and contracting, monitoring and tracking procured goods and services, and disbursements of project funds. The CBC stated there were unwritten controls in place. However, it did not follow its own procedures. This included its failure to oversee the activities of its former Property Manager.

We did not observe any substantive changes in CBC's control systems subsequent to our review period to ensure project resources are currently safeguarded against waste, loss, and misuse.

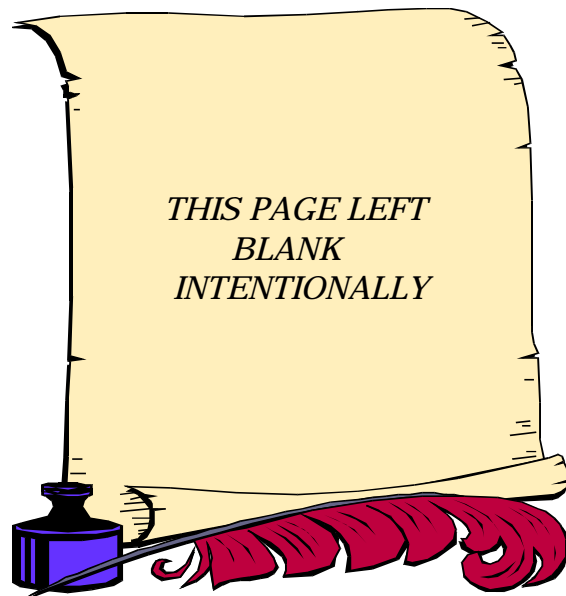


## Schedule of Questioned Costs

<b>Issue</b>	<b>Ineligible <sup>1/</sup></b>
<b>Jack Hall Waipahu Renovations</b>	
Duplicate Payments	\$20,280
Painting	34,020
<b>Total</b>	<b>\$54,300</b>
<b>Carpet Installation</b>	
Jack Hall Waipahu	\$83,876
Westlake	17,659
<b>Total</b>	<b>\$101,535</b>
<b>Painting and Roofing – Westlake</b>	<b>95,212</b>
<b>Garbage Collection Services</b>	
Jack Hall Waipahu	\$38,553
Westlake	11,918
Kulana Nani	18,285
<b>Total</b>	<b>\$68,756</b>
<b>Pest Control Services</b>	
Jack Hall Waipahu	\$30,536
Westlake	20,130
Kulana Nani	4,456
<b>Total</b>	<b>\$55,122</b>
<b>Kulana Nani Elevator Preventative Maintenance</b>	<b>\$27,155</b>
<b>Grand Total</b>	<b>\$402,080</b>

<sup>1/</sup> Ineligible costs are costs charged to a HUD-insured or HUD-subsidized program or activity the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations.

NOTE: Due to the owners of Jack Hall Waipahu prepaying the HUD-insured mortgage and not being bound by the terms of the Regulatory Agreement, they will not be required to repay their above ineligible costs.



# Details of Ineligible Carpeting Costs

JACK HALL WAIPAHU CARPETING INSTALLED BY INDEPENDENT INSTALLERS							
UNIT #	BED ROOM 1 or 2	CHK #	DATE	AMOUNT	ALLOWED*	INELIGIBLE	REMARKS
259	1	141	2/17/94	\$1,250.00	\$588.50	\$661.50	
218/217/170	2/2/1	90019	2/24/94	\$4,316.00	\$2,072.50	\$2,243.50	
156	1	193	3/30/94	\$1,250.00	\$588.50	\$661.50	
220/258/131	2/1/1	221	4/21/94	\$3,950.00	\$1,919.00	\$2,031.00	
212/217	2/2	304	6/22/94	\$3,016.00	\$742.00	\$2,274.00	217 dup
107/254	2/1	349	7/28/94	\$2,808.00	\$1,330.50	\$1,477.50	
171	1	90060	8/15/94	\$1,300.00	\$588.50	\$711.50	
228	1	490	11/15/94	\$1,300.00	\$588.50	\$711.50	
807	N/A	490	11/15/94	\$1,508.00	\$0.00	\$1,508.00	no unit
150	1	490	11/15/94	\$1,300.00	\$588.50	\$711.50	
205	2	90067	9/15/94	\$1,586.00	\$742.00	\$844.00	
121	1	538	12/21/94	\$1,300.00	\$588.50	\$711.50	
159	1	538	12/21/94	\$1,300.00	\$588.50	\$711.50	
265	1	593	1/24/95	\$1,300.00	\$595.00	\$705.00	
135/139	1/1	635	2/14/95	\$2,704.00	\$1,190.00	\$1,514.00	
135	1	635	2/14/95	\$1,352.00	\$0.00	\$1,352.00	135 dup
255	1	664	3/7/95	\$1,354.00	\$595.00	\$759.00	
234	1	682	3/21/95	\$1,352.00	\$595.00	\$757.00	
141/272	1/1	690	3/30/95	\$2,708.00	\$1,190.00	\$1,518.00	
119/261	2/1	710	4/6/95	\$2,912.00	\$1,345.00	\$1,567.00	
119/261/240	2/1/1	753	4/27/95	\$4,264.00	\$595.00	\$3,669.00	119/261 dups
202/267	2/1	811	5/25/95	\$2,912.00	\$1,345.00	\$1,567.00	
216/162	2/1	876	7/13/95	\$2,912.00	\$1,345.00	\$1,567.00	
160/126	1/1	876	7/13/95	\$2,684.00	\$1,190.00	\$1,494.00	
169/161	1/1	961	8/22/95	\$2,704.00	\$1,190.00	\$1,514.00	
128	1	990	9/13/95	\$1,352.00	\$595.00	\$757.00	
158	1	1001	9/20/95	\$1,352.00	\$595.00	\$757.00	
162/257	1/1	1046	10/19/95	\$2,704.00	\$595.00	\$2,109.00	162 dup
110/111/157	2/2/1	1072	11/6/95	\$4,706.00	\$2,095.00	\$2,611.00	
257/137/108	1/1/2	1108	12/4/95	\$4,373.00	\$1,345.00	\$3,028.00	257 dup
no inv found	2/2/1	1154	1/4/96	\$4,706.00	\$2,116.00	\$2,590.00	
210/260	2/1	1166	1/12/96	\$3,250.00	\$1,358.50	\$1,891.50	

Appendix B

UNIT #	BED ROOM 1 or 2	CHK #	DATE	AMOUNT	ALLOWED*	INELIGIBLE	REMARKS
268	1	1208	2/13/96	\$1,430.00	\$601.00	\$829.00	
144/208	½	1256	3/13/96	\$3,068.00	\$1,358.50	\$1,709.50	
107	2	1296	4/4/96	\$1,625.00	\$757.50	\$867.50	
251/259	1/1	1350	5/6/96	\$2,912.00	\$1,202.00	\$1,710.00	
239/105	½	1350	5/6/96	\$3,068.00	\$1,358.50	\$1,709.50	
269/270/122	1/1/1	1403	6/5/96	\$4,368.00	\$1,803.00	\$2,565.00	
244/166	1/1	1442	7/3/96	\$2,912.00	\$1,202.00	\$1,710.00	
244/214/145	1/2/1	1452	7/5/96	\$4,654.00	\$1,358.50	\$3,295.50	244 dup
140/205	1/2	1506	8/9/96	\$3,000.00	\$1,358.50	\$1,641.50	
138	1	1507	8/9/96	\$1,500.00	\$601.00	\$899.00	
124/164/249	1/1/1	1572	9/11/96	\$4,056.00	\$1,803.00	\$2,253.00	
130	1	1605	10/4/96	\$1,352.00	\$601.00	\$751.00	
115	2	1653	11/6/96	\$1,352.00	\$757.50	\$594.50	
265	1	1654	11/6/96	\$1,352.00	\$601.00	\$751.00	
238	1	1741	1/6/97	\$1,300.00	\$607.50	\$692.50	
201	2	1783	2/5/97	\$1,560.00	\$765.50	\$794.50	
215	2	1784	2/5/97	\$1,560.00	\$765.50	\$794.50	
237	1	1802	2/12/97	\$1,352.00	\$607.50	\$744.50	
266	1	1808	2/19/97	\$1,352.00	\$607.50	\$744.50	
213	2	1833	3/12/97	\$1,560.00	\$765.50	\$794.50	
204	2	1922	5/5/97	\$1,560.00	\$765.50	\$794.50	
120	2	1922	5/5/97	\$1,560.00	\$765.50	\$794.50	
214	2	1922	5/5/97	\$1,560.00	\$765.50	\$794.50	
253	1	1922	5/5/97	\$1,352.00	\$607.50	\$744.50	
219	2	1922	5/5/97	\$1,560.00	\$765.50	\$794.50	
251/254	1/1	1961	6/5/97	\$2,704.00	\$1,215.00	\$1,489.00	
154/245/151	1/1/1	2001	7/7/97	\$4,056.00	\$1,822.50	\$2,233.50	
109	2	2109	9/18/97	\$1,560.00	\$765.50	\$794.50	
223	1	2150	10/14/97	\$1,408.00	\$607.50	\$800.50	
113/155	2/1	2172	11/5/97	\$3,034.00	\$1,373.00	\$1,661.00	
133	1	2172	11/5/97	\$1,408.00	\$607.50	\$800.50	
TOTAL				\$143,630.00	\$59,754.00	\$83,876.00	

KEY:

\*Allowed cost for carpeting:

1994 1 bedroom - \$588.50 (94% of \$626)

1994 2 bedroom - \$742.00 (94% of \$789)

1995 1 bedroom - \$595.00 (95% of \$626)

1995 2 bedroom - \$750.00 (95% of \$789)

1996 1 bedroom - \$601.00 (96% of \$626)

1996 2 bedroom - \$757.50 (96% of \$789)

1997 1 bedroom - \$607.50 (97% of \$626)

1997 2 bedroom - \$765.50 (97% of \$789)

dup = duplicate payment for same unit

no unit = there is no such unit number at Jack Hall Waipahu

**WESTLAKE CARPETING  
INSTALLED BY INDEPENDENT INSTALLERS  
(All 2-bedrooms)**

UNIT #	CHECK #	DATE	AMOUNT	ALLOWED*	INELIGIBLE	REMARKS
203/204/408	15335	3/7/94	\$4,350.00	\$3,298.95	\$1,051.05	
408	15866	5/13/94	\$1,450.00	\$0.00	\$1,450.00	dup
405/411	16044	6/8/94	\$3,016.00	\$2,199.30	\$816.70	
711	16201	7/8/94	\$1,450.00	\$1,099.65	\$350.35	
305	93960	9/15/94	\$1,508.00	\$1,099.65	\$408.35	
802	17496	1/6/95	\$1,508.00	\$1,111.11	\$396.89	
503	17597	1/18/95	\$1,508.00	\$1,111.11	\$396.89	
703	17656	1/24/95	\$1,500.00	\$1,111.11	\$388.89	
706	17865	2/21/95	\$1,570.00	\$1,111.11	\$458.89	
609	18053	3/14/95	\$1,560.00	\$1,111.11	\$448.89	
208/211/807	18614	5/11/95	\$2,400.00	\$2,222.21	\$177.79	1st partial
812	18945	6/22/95	\$1,508.00	\$1,111.11	\$396.89	
610	19038	6/29/95	\$1,508.00	\$1,111.11	\$396.89	
208/211/807	19080	7/6/95	\$2,304.00	\$1,111.11	\$1,192.89	2nd partial
208	39	10/11/95	\$1,568.00	\$0.00	\$1,568.00	dup
901	82	11/20/95	\$1,568.00	\$1,111.11	\$456.89	
211	195	3/13/96	\$1,788.00	\$0.00	\$1,788.00	dup
401	423	9/11/96	\$1,750.00	\$1,122.56	\$627.44	
501	430	9/18/96	\$1,750.00	\$1,122.56	\$627.44	
609	519	11/20/96	\$1,800.00	\$1,122.56	\$677.44	
408	654	3/12/97	\$1,892.00	\$1,134.02	\$757.98	
512/409	871	10/14/97	\$3,785.00	\$2,268.03	\$1,516.97	
508/504	950	12/10/97	\$3,785.00	\$2,268.03	\$1,516.97	
606	960	12/17/97	\$1,976.00	\$1,134.02	\$841.98	
			\$44,452.00	\$26,792.54	\$17,659.46	



KEY:

\*Allowed cost for carpeting:

1994 = \$1,099.65 (96% of \$1,145.47)

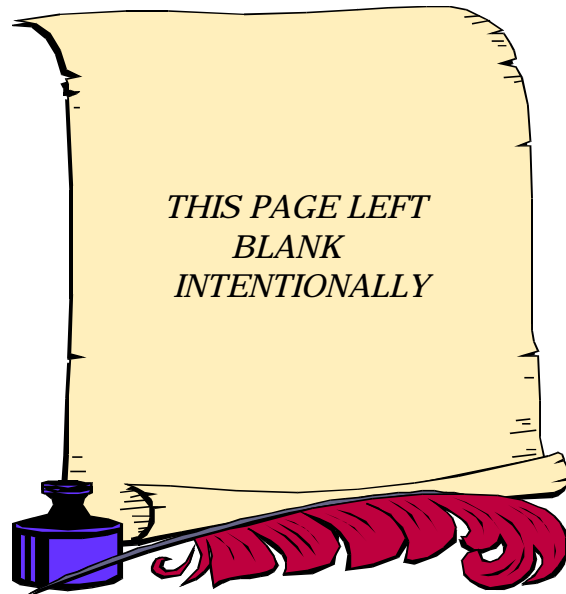
1995 = \$1,111.11 (97% of \$1,145.47)

1996 = \$1,122.56 (98% of \$1,145.47)

1997 = \$1,134.02 (99% of \$1,145.47)

Dup = duplicate

partial = partial payment - 2d payment 7/6/95

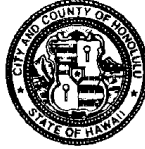


# Auditee Comments

DEPARTMENT OF FACILITY MAINTENANCE  
**CITY AND COUNTY OF HONOLULU**

1000 Uluohia Street, Suite 215, Kapolei, Hawaii 96707  
 Phone: (808) 692-5054 • Fax: (808) 692-5857  
 Website: www.co.honolulu.hi.us

JEREMY HARRIS  
 MAYOR



LARRY LEOPARDI, P.E.  
 DIRECTOR AND CHIEF ENGINEER

ALVIN K.C. AU  
 DEPUTY DIRECTOR

IN REPLY REFER TO:  
**PBEM 03-0152**

May 12, 2003

Joan S. Hobbs, Regional Inspector General for Audit  
 U.S. Department of Housing and Urban Development  
 Office of Inspector General  
 Region 9  
 611 West Sixth Street, Suite 1160  
 Los Angeles, California 90017


Dear Ms. Hobbs:

Thank you for the opportunity to provide comments and information on the draft audit report of your review of Chaney, Brooks and Company dated March 13, 2003. The attached response was prepared with available records under the time constraints provided. Please note the City was the victim of a collusive fraud scheme during the time period covered by the audit.

As previously mentioned in our April 4, 2003 letter, the Jack Hall Waipahu project is not a City and County of Honolulu owned project and as such we do not have any responsibility for the management or operation of the project. Therefore, our comments, which are attached, are confined only to the sections of the report concerning the Kulana Nani and Westlake projects. To avoid confusion, we would recommend either 1) deleting Jack Hall from the draft report, or 2) clarifying that Jack Hall was not a City project by including the following statement in the Executive Summary, "For clarification purposes, Jack Hall Waipahu is not a City and County of Honolulu project." and bifurcating the final audit report between City projects and other projects.

If you have any questions, please contact Internal Control Division Chief Michael Hansen at (808) 523-4472. Thank you for your consideration.

Sincerely,

  
 LARRY J. LEOPARDI, P.E.  
 Director and Chief Engineer

LJL:sln

Attachments

**City and County of Honolulu  
City Comments on Draft Audit Report  
HUD Office of Inspector General Review of Chaney, Brooks and Company**

**Executive Summary Comments:**

- Collusive fraud contributed to the losses at Kulana Nani and Westlake.
- The City initiated the fraud investigation based on a tip by a City employee.
- The City took immediate and prudent steps to expose and stop the fraud in 1997.
- The City prosecuted the individuals involved in the fraud and cooperated with the separate HUD OIG investigation.
- Financial audits between 1994 and 1997 by independent CPA's did not reveal any fraud.
- Reviews by HUD between 1994 and 1997 did not reveal any fraud.
- The City implemented additional controls to prevent similar fraud schemes.
- The Audit Report should credit the City for the initiative and action taken to investigate and prosecute the individuals involved in the collusive fraud.

**City and County of Honolulu  
City Comments on Draft Audit Report  
HUD Office of Inspector General Review of Chaney, Brooks and Company**

**Overall Comments:**

During the period covered by the Draft Audit Report (Audit) (1994 through 1997) the City and County of Honolulu (City) obtained independent CPA performed financial audits for both Kulana Nani and Westlake, and submitted the required reports to the U. S. Department of Housing and Urban Development (HUD) detailing the financial activities of each project. Throughout this period neither the independent auditors nor HUD notified the City that anything was unusual at these projects. It was not until the City initiated its own investigation based on internally generated information alleging improprieties at the Kulana Nani and Westlake projects that the City learned it was the victim of a collusive fraud scheme.

Chaney, Brooks and Company (CBC) and their lack of management oversight was the focus of the Audit; however the report attributes all of the questioned costs to the City. The City understands its responsibility as owner; however, we believe the City should not be required to reimburse the Kulana Nani and Westlake projects, as the City was the victim of a collusive fraud scheme during the time period in question.

Accordingly, we would request the Audit discuss the initiative and steps taken by the City to address the collusive fraud scheme perpetrated against the City. The fraud included not only Kulana Nani and Westlake but other non-HUD projects operated by the City as well. The non-HUD projects involved City relocation services for commercial tenants at City owned properties. The two City employees involved in the fraud scheme were fired.

The City investigation of alleged improprieties at Kulana Nani and Westlake began in November 1997. The initial investigation identified information that appeared to link the CBC property manager to the improprieties. The City immediately took action and approached CBC senior management to request that the suspected CBC property manager be taken off all City projects. CBC complied with the City request and replaced the property manager in December 1997. At this point, all prior and recurring transactions were suspect and the City instructed CBC to review all contracts for each of these projects.

The internal investigation by the City continued during the first part of 1998. Once sufficient information was gathered regarding the improprieties, the information was turned over to the Honolulu Police Department (HPD) and City Prosecutors Office for criminal investigation. In addition, in early March 1998 the information related to Kulana Nani and Westlake was turned over to the HUD Office of Inspector General (HUD OIG) via a meeting with special agent Mel Bernard. At that time it was our understanding that HUD OIG would be undertaking its own investigation and seek federal criminal prosecution of those involved. A description of the assistance provided to HUD OIG by the City Prosecutors Office is included in *Attachment A*.

**City and County of Honolulu  
City Comments on Draft Audit Report  
HUD Office of Inspector General Review of Chaney, Brooks and Company**

Parallel criminal investigations by HPD were being performed on the non-HUD projects and the Kulana Nani and Westlake projects. Our internal investigation revealed that many of the same individuals were involved in aspects of the collusive fraudulent scheme at both HUD and non-HUD projects. Our internal investigation also revealed that the level of collusion was widespread and included City employees, contractors/vendors, commercial tenants and the CBC property manager.

Ultimately, the investigation led to criminal charges and prosecution of the individuals involved. A supervisory City employee, the owner of Specialty Pacific Builders (SPB), the owner of Pest Managing-Hawaii (PMH) and others were successfully prosecuted. The individual identified in the Audit on page 16 as the commissioned salesperson for SPB and a second City employee were indicted on charges stemming from the collusive fraud scheme but died prior to trial. In addition, the CBC property manager died prior to criminal charges being filed.

As reflected above, the City was the victim of a massive collusive fraud scheme and tragically, collusion can render even the best controls ineffective. In this case, however, the City identified the fraud, took immediate action to stop the fraud, and prosecuted those surviving individuals involved. As the City successfully prosecuted those involved in the collusive fraud scheme, we are perplexed as to the necessity for the HUD OIG recommending that the City reimburse the Kulana Nani and Westlake projects. The City is concerned that the Audit is being completed at this time rather than in 1998, as the substantial delay will seriously hamper the City's ability to collect reimbursement from CBC.

As a result of this situation, the City has also implemented additional controls for all projects to try and insure that such a scheme is not perpetrated against the City in the future. A recap of the nature and scope of the current City monitoring and control procedures for property management contracts are provided in *Attachment B*.

**Comments Specific to the Report:**

Audit Objective (page 1)

- We believe the Audit needs to clarify when HUD OIG received information from the City regarding alleged improprieties.
- The Audit should state, "The City reported to HUD OIG in 1998 alleged improprieties at the Kulana Nani and Westlake projects."

**City and County of Honolulu  
City Comments on Draft Audit Report  
HUD Office of Inspector General Review of Chaney, Brooks and Company**

**Finding 1: CBC Property Manager Used Project Funds For Unreasonable and Unnecessary Expenses (pages 5 and 6)**

- The Audit attributes the cause of the finding to CBC's and the owner's lack of management controls. The cause actually was that the controls in place were overridden and circumvented by the responsible property managers through collusion in an effort to defraud the City and steal from the Kulana Nani and Westlake projects. We would suggest this cause be stated in the Audit.
- The Audit states that the Regulatory Agreements provide that..."(2) the payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services, supplies or materials." However, the 1986 Regulatory Agreement for Kulana Nani reads "(b) Payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services, supplies, or materials in the area where the services are rendered or the supplies or materials furnished." This disclosure should be clarified in the Audit.
- HUD Handbook 4381.5 paragraph 1.6a states that "while HUD will work with management agents and monitor their performance, the property owner is ultimately responsible for a project's compliance with HUD regulators and requirements." HUD Handbook 4381.5 paragraph 1.6a also goes on to state that "HUD expects that owners will oversee the performance of their management agents and take steps to correct deficiencies that occur." As previously mentioned, upon discovery of the collusive fraud scheme, the City took immediate steps to correct the situation in accordance with HUD Handbook 4381.5 paragraph 1.6a. This action should be disclosed in the Audit.
- HUD Handbook 4381.5 paragraph 1.7a states in pertinent part, that "[a]ctivities of HUD Area Office staff include providing assistance to help agents meet their responsibilities, monitoring agent activities for compliance with laws, regulations and the provisions of subsidy contracts and regulatory agreements..."

**Westlake – Excessive and Duplicative Carpet Installation Costs (pages 13-15)**

- Independent Installers was identified by the City as a sole source vendor selected by the CBC property manager. Documents related to Independent Installers were included in the information provided to HUD OIG in 1998.
- Independent Installers has not been used at a City project since December 1997.
- The Audit report determines the Westlake excessive carpet installation costs based on a comparison to work done by Wayne's Carpet in December 1998 costing \$1,145 per unit. In reviewing the Wayne's Carpet proposal and invoice, the work specifically excluded removal of old carpet, preparation of the floor for

**City and County of Honolulu  
City Comments on Draft Audit Report  
HUD Office of Inspector General Review of Chaney, Brooks and Company**

the new carpet, and moving furniture. A copy of the proposal is included as *Exhibit 1*. The labor costs to perform these tasks can be significant and may explain some of the difference between Wayne's Carpet price and Independent Installers price.

Roofing and Painting Costs For Westlake Were Excessive (pages 15-17)

- The owner of SPB (Donna Abelaye) pled no contest and was convicted of theft and money laundering charges in April 2000 for her involvement in the collusive fraud scheme on non-HUD projects. In our opinion, the statements disclosed in the draft audit report attributed to the owner of SPB are therefore suspect and unreliable.
- The SPB commissioned salesperson (Russell Williams) died before trial on charges relating to the collusive fraud scheme on non-HUD projects.
- SPB was a company that was identified as suspect by the City and reported to HUD OIG in 1998.
- The owner of Salcedo Roofing, a company that had bid to perform the roofing work, represented to the City that the cost to re-roof the Westlake Apartments in accordance with the specifications included in the SPB bid would be \$53,000. The amount paid to SPB for the Westlake roofing job was \$81,250. The difference of \$28,250 we consider the excessive amount of the fraudulent transaction.
- Based on the documents turned over to HUD OIG the bid of SPB for the painting was actually \$102,995 and the change order was \$15,000. In addition, the CBC property manager paid SPB an additional \$3,190 for an unknown reason. The total paid to SPB for the Westlake painting job was \$121,185. Décor Builders, the company that actually performed the painting work, was paid \$66,473. The difference of \$54,712 we consider the excessive amount of the fraudulent transaction.
- Our computation indicates the excessive amount of the fraudulent roofing (\$28,250) and painting (\$54,712) contracts paid to SPB totals \$82,962.

Garbage Collection Costs at Westlake and Kulana Nani (pages 18-19)

- The CBC property manager solely handled the contracting for refuse service at Westlake and Kulana Nani. In addition, the CBC property manager was responsible for approving refuse service invoices for payment.



**City and County of Honolulu  
City Comments on Draft Audit Report  
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- In February 1998, CBC obtained bids for Kulana Nani refuse service and entered into a contract with Alii Refuse Corporation for \$1,796 a month. A copy of the service agreement is included as *Exhibit 2*. The contract included a refuse service volume of 25% less than the volume bid by Browning Ferris Industries of Hawaii in November 1995. The change in refuse service provider was the direct result of the City request for CBC to review all contracts at Kulana Nani.
- The Audit does not disclose and we have not been able to locate any documents from CBC regarding the level of service and volume billed by The Refuse Inc. or National Refuse Company for Kulana Nani during the audit period. Without this information we believe, due to the significant fluctuations in contracted refuse volume, that the Audit relies on too many assumptions for the conclusion reached regarding the amount of ineligible cost for refuse service at Kulana Nani and Westlake.
- The Refuse Inc. is no longer in business.

**Pest Control Costs at Westlake and Kulana Nani (pages 21-23)**

- The owner of PMH (Claude Hebaru) pled no contest and was convicted of theft and money laundering charges in April 2000 for his involvement in the collusive fraud scheme on non-HUD projects.
- PMH was a company identified as suspect by the City and was reported to HUD OIG in 1998.
- In September 1998, under the guidance of the new CBC property manager, CBC contracted with Environ Control Inc. (ECI) to perform interior pest control services for \$3,216 and exterior treatment for \$310 per quarter at Westlake. Copies of the proposals are included as *Exhibit 3* and *4*. The contract with ECI is considered arms length, represents actual costs and is closer to the period under review than the comparables used in the Audit. Furthermore, an ECI bid was used in the Audit for the eligible cost analysis of Kulana Nani pest control services. Therefore, these costs appear to be reasonable costs for purposes of the Westlake analysis and result in a different conclusion as to the amount of ineligible costs.
- Based on the ECI actual costs, the Westlake exterior treatment cost would be considered reasonable (\$310 vs. \$291) and the questioned portion of the five interior treatments identified in the Audit for Westlake would be \$5,944 (\$22,024 less \$16,080).

**City and County of Honolulu  
City Comments on Draft Audit Report  
HUD Office of Inspector General Review of Chaney, Brooks and Company**

Elevator Preventive Maintenance Costs at Kulana Nani Were Excessive (pages 23-24)

- CBC replaced the property manager for Kulana Nani and Westlake in December 1997 as a direct result of a request by the City. CBC performed an internal review of the property manager and fired the property manager in March 1998.
- The inquiry by CBC into the elevator maintenance service contract was a direct result of the City request for CBC to review all existing contracts. We agree that CBC had the responsibility to put the Kulana Nani elevator services contract out to bid in a timely manner.
- In 1996 CBC entered into a contract for elevator preventative maintenance of the two elevators at Westlake with Hawaiian Pacific Elevator at a monthly cost of \$900. The contract is considered arms length. Kulana Nani has four times as many elevators as Westlake.
- The analysis in the Audit for Kulana Nani elevator preventive maintenance costs does not address scope of services, the effect of changes in market conditions and competitive forces between 1996 and 2001. The City does not have any information to indicate that the contracted elevator maintenance company was involved in the collusive fraud scheme. Without such information and analysis, we believe the Audit relies on too many assumptions for the conclusion reached regarding the amount of ineligible cost for elevator preventive maintenance.

Recommendations (page 25)

- The City believes that under the above-mentioned circumstances, the City should not be required to repay any ineligible costs to the projects. As reflected above, the City was the victim of a collusive fraud scheme.
- The City took prudent and immediate steps to follow up on information that exposed the collusive fraud discovered by the City in 1997. The City reported the fraud to HUD OIG in early 1998 and fully assisted HUD OIG in their efforts to investigate the collusive fraud. The City expended significant resources and effort to investigate and prosecute the collusive fraud. The City has been awaiting federal legal action against individuals involved in the fraud.
- The U.S. Attorney should prosecute those involved in the collusive fraud scheme. In that event, those who are actually responsible for the ineligible costs referred to in the Audit would be held responsible to pay restitution to the projects.

**City and County of Honolulu**  
**City Comments on Draft Audit Report**  
**HUD Office of Inspector General Review of Chaney, Brooks and Company**

- CBC had a fiduciary duty to safeguard the project funds. CBC was responsible to contract for goods and services and approve invoices for payment. CBC directly contributed to the loss resulting from the collusive fraud scheme at Kulana Nani and Westlake through the involvement of the CBC property manager and lack of CBC management controls as disclosed in the Audit. Accordingly, the City has begun the process to pursue CBC for reimbursement.

DEPARTMENT OF THE PROSECUTING ATTORNEY  
**CITY AND COUNTY OF HONOLULU**

*Attachment A*

ALII PLACE  
1060 RICHARDS STREET • HONOLULU, HAWAII 96813  
PHONE: (808) 527-6494 • FAX: (808) 527-5811

RECEIVED  
CORPORATION COUNSEL  
C AND C OF HONOLULU



03 MAY -2 A9 50

PETER B. CARLISLE  
PROSECUTING ATTORNEY

IWALANI D. WHITE  
FIRST DEPUTY PROSECUTING ATTORNEY

REFERRED TO

May 2, 2003

David Z. Arakawa, Esq.  
Corporation Counsel  
Tammy Kaneshiro, Esq.  
Deputy Corporation Counsel  
Department of the Corporation Counsel  
City and County of Honolulu  
530 South King Street, Room 110  
Honolulu, Hawaii 96813

Re: Kulana Nani and Westlake Apartments

Dear Arakawa and Ms. Kaneshiro:

I have forwarded to you the police reports and materials in our possession regarding the City's Kulana Nani and Westlake Apartments.

Historically, the Department of the Prosecuting Attorney and the Honolulu Police Department conducted an investigation on all of the City related projects handled by Defendant Michael Kahapea to determine whether criminal wrongdoing had been committed by Defendant Kahapea. The investigation into these projects was as a result of an initial investigation and prosecution of Defendant Kahapea's handling of the Ewa Villages Relocation Project. What was discovered from this investigation was that Defendant Kahapea had fraudulently stolen 5.8 Million Dollars from the City and County of Honolulu.

Defendant Kahapea was a City employee who was assigned to handle various Relocation and Managing Projects for the City and County of Honolulu. He had been employed for a number of years and no one suspected Defendant Kahapea of violating his position of trust and steal from the City and County of Honolulu.

David Z. Arakawa, Esq.  
Tammy Kaneshiro, Esq.  
Page 2 of 4  
May 2, 2003

The Ewa Village investigation resulted in the investigation and prosecution of Defendant Kahapea for fraudulently stealing monies from the City's Westloch Project, Middle Street project and the Kulana Nani and Westlake Apartments Laundry fund. Defendant Kahapea was convicted in each case.

Our investigation went further and we discovered that Defendant Kahapea used his position to defraud the projects being funded by the U.S. Department of Housing and Urban Development.

We had learned that Defendant Kahapea solicited repair bids relating to the Kulana Nani and Westlake Apartments. Upon receipt of these bids, Defendant Kahapea together with several Co-Defendants, fraudulently altered the valid bids by inflating the amount of the bid, and submitted lower false bids from these Co-Defendants in order to justify the awarding of the job to the Co-Defendants' Companies. After awarding the job(s) to the Co-Defendants' Companies, the original legitimate bidding company was subcontracted and given the job to perform and the Co-Defendants realized a substantial profit without doing any work.

Because the use of federal funds was involved, this matter was turned over to the U.S. Department of Housing and Urban Development. The agent involved was Ms. Joyce K. McGlothlen, Special Agent, Office of the Inspector General, San Francisco, California.

Ms. McGlothlen traveled to Hawaii approximately 10-12 times as part of the investigation. She was provided with an office to use within the Department of the Prosecuting Attorney's Office, was assisted by Mr. George Elerick, Investigator, Prosecutor's Office, and was provided with any assistance she may have needed to further the investigations. Ms. McGlothlen's supervisor was Mr. Mel Bernard.

Based on my conversations with Ms. McGlothlen, she confirmed the fraudulent actions of Defendant Kahapea relating to the Kulana Nani and Westlake Apartments and uncovered fraudulent activities relating to Jack Hall and the Kahuku Village.

Ms. McGlothlen indicated that she had met with Mr. Elliot Enoki and Mr. Les Osborne, United States Attorney's Office, and that the matter was being accepted for prosecution by the United States Attorney's Office.

David Z. Arakawa, Esq.  
Tammy Kaneshiro, Esq.  
Page 3 of 4  
May 2, 2003

Ms. McGlothlen traveled numerous times to Hawaii to complete her investigation and meet with the United States Attorney's Office, in furtherance of their prosecution. On each occasion, Ms. McGlothlen would stop at the Department of the Prosecuting Attorney's Office and provide Mr. Elerick and myself with an update on the pending status of the investigation/prosecution of the HUD matters.

While prosecuting Defendant Kahapea in the Ewa Village case, I had called Ms. McGlothlen and Mr. Osborne on a number of occasions to determine the status of the federal prosecution. It was my understanding from Defendant Kahapea's attorney that if the federal matter was resolved, Defendant Kahapea would admit to the charges in State Court.

Ms. McGlothlen initially informed me that she had no information regarding the status of the federal prosecution. She later indicated that "immunity" had been provided to Defendant Kahapea's Co-Defendants in return for their testimony against Defendant Kahapea.

Since no action had been taken by the United States Attorney's Office, Defendant Kahapea elected to litigate the Ewa Village Case. After four months of trial, Defendant Kahapea was convicted and sentenced to imprisonment in State Court.

Following the conviction of Defendant Kahapea, I was notified by Mr. Les Osborne that the United States Attorney's Office had elected not to prosecute Defendant Kahapea in the HUD matter.

Ms. McGlothlen was upset with Mr. Osborne's decision and indicated that her supervisor, Mr. Bernard was equally disappointed with the decision of the United States Attorney's Office.

Please be advised that the Honolulu Police Department and the Department of the Prosecuting Attorney provided the U.S. Department of Housing and Urban Development with the accommodations and assistance to further its investigation and prosecution of Defendant Kahapea.

We firmly believed and still believe that Defendant Kahapea should be prosecuted for stealing the hundreds of thousands of dollars from the Department of Housing and Urban Development.

David Z. Arakawa, Esq.  
Tammy Kaneshiro, Esq.  
Page 4 of 4  
May 2, 2003

If there are any questions, please feel free to call me at 523-4516 to discuss this matter.

Very truly yours,

A handwritten signature in black ink, appearing to read "R.K.O. LEE". The signature is stylized with a large, looping initial "R" and a long horizontal stroke.

RANDAL K. O. LEE  
Deputy Prosecuting Attorney

RKOL:pm

cc: Peter B. Carlisle, Esq.  
Major Daniel Hanagami

Attachment B

**OVERVIEW OF PROPERTY MANAGEMENT BRANCH MONITORING AND CONTROL PROCEDURES OF CITY PROPERTY MANAGEMENT CONTRACTS**

- I. **Monitoring Procedures:**
  - A. **Formal Request for Contract Approval:** The Property Management Agent (Agent) is required to submit to the City a formal letter for all contracted work. The letter includes the scope of work, and efforts made to solicit proposals by the Agent as required.
    - 1. The City staff (Staff) reviews the package of information and contacts both Agent and Proposed Contractor, if necessary.
    - 2. The Staff visits the property to confirm the scope of work.
  - B. **City Division Approval:** The Staff, branch supervisor, and division chief approvals are required on non-budgeted transactions that exceed \$500.00. For example:
    - 1. Unit carpet / appliance replacements
    - 2. Elevator maintenance
    - 3. Building concrete repair
  - C. **Digital Photo Documentation:** Digital pictures are taken by Staff before purchase / project and after purchase / project to provide visual proof that contract is completed.
  - D. **Financial Reports:** The Staff, branch supervisor and division chief each review and approve the monthly financial, subject to audit.
    - 1. If discrepancies or unexplained budget variances are noted, the Agents are informed that explanations and adjustments are required within two weeks.
    - 2. The Financial Statements of the project are audited annually by a Certified Public Accountant.
  
- II. **Management Inspections:**
  - A. **Monthly Inspection:** Staff and the Agent conduct monthly inspections. Key management areas, such as occupancy practices and on-site record keeping are examined. The Agent has 30 days to correct all noted discrepancies.
  - B. **Annual Inspection:** Staff with HUD and the Agent conducts annual inspections. Written inspection reports are kept on file. All noted discrepancies on annual inspections are remedied within two (2) weeks notice and HUD is informed of such.
  - C. **Record Keeping:** The Staff requires monthly report submittals by Agent on-site staff and during monthly inspections; these reports are checked and verified for consistency (i.e. inventory).



- III. **Hiring of Additional City Personnel:**
  - A. Duties Divided: Three (3) additional City contract workers have been hired to distribute the control of one (1) City property manager and to alleviate the scope of responsibilities to ensure adequate and efficient monitoring of the Agents between several City property managers.
  
- IV. **Enforcement of Documents:**
  - A. Regulatory Agreement: Ensure the replacement reserve fund is established and maintained by reviewing the financial reports.
  - B. Management Certifications: Ensure Agent complies with HUD requirements and contract obligations, notices and policy directives that relate to the management. Also, certify Agent's insurance policies by requesting copies for current year coverages that name the City as additional insured.
    - 1. Ensure that all contractual expenses relating to the project are reasonable and necessary by reviewing the financial reports and conducting on-site inspections.
  - C. HUD Handbook 4381 (Management Agent Handbook): Conduct monthly inspections of common areas and unoccupied units as well as perform annual unit inspections of all project units to ensure that decent, safe, and sanitary housing is provided.
  - D. HUD Handbook 4370: Ensure that the Agent adheres to the guidelines set forth by HUD through regular communication, on site inspection and reviews with the Agent.
  - E. Management Contracts: Ensure the Agent complies with the provisions as set forth in the management contract by the City's regular review and reference to the contractual document.
    - 1. Weekly meetings are scheduled with the Agents to discuss new findings, determine if any assistance is needed, determine and verify if improvement projects are needed, etc. The Staff emphasizes the Agent's strict compliance with the management contract.

**WAYNE'S CARPET**

Exhibit I

KAIMUKI, 3025 Wai'alea Ave. 735-3005 732-1934 Fax  
 WAIMALU, 98-027 Hekaha St. 487-8980  
 SAND ISLAND, 330 Sand Island Access Rd. 841-6183  
 MAUI, 401 Hookahi St. #14-18 242-6102  
 Contractor # C 12015, C-7, C-21 & C-51

PROPOSAL SUBMITTED TO: CHANEY BROOKS PHONE: \_\_\_\_\_ DATE: 12/12/98  
 STREET: 606 CORAL ST. JOB NAME: WESTLAKE APPTS.  
 CITY, STATE AND ZIP CODE: HONOLULU, HAWAII 96813 JOB LOCATION: \_\_\_\_\_  
 ARCHITECT: \_\_\_\_\_ DATE OF PLANS: \_\_\_\_\_ JOB PHONE: 839-206

We hereby submit specifications and estimates for:

FURNISH & INSTALL NEW CARPET - DIRECT BLUE DOD  
CUSTOMER TO REMOVE OLD CARPET & PREPARE /  
PROVIDE FLOORS READY FOR CARPET.  
CUSTOMER TO REMOVE & REPLACE ALL FURNITURE  
CARPET - WOOL.  
COLOR - BLUE MIST \$1,100.00  
TAX 45.45  
TOTAL \$1,145.45

I, the Proposer hereby to furnish material and labor - complete in accordance with above specifications, for the sum of \_\_\_\_\_ dollars (\$ 1,145.45).

Payment to be made as follows: \_\_\_\_\_

All material is guaranteed to be as specified. All work to be completed in a workmanlike manner according to standard practices. Any alteration or deviation from above specifications involving extra costs will be credited only upon written orders, and will become an extra charge over and above the estimate. All agreements contingent upon strikes, accidents or delays beyond our control. Owner to carry fire, liability and other necessary insurance. Our workers are fully covered by Workmen's Compensation Insurance.

Authorized Signature: Gudy V. Gaudy  
 Note: This proposal may be withdrawn by us if not accepted within \_\_\_\_\_ days.

Acceptance of Proposal - The above prices, specifications and conditions are satisfactory and are hereby accepted. You are authorized to do the work as specified. Payment will be made as outlined above.  
 Signature: \_\_\_\_\_  
 Date of Acceptance: \_\_\_\_\_  
 Signature: \_\_\_\_\_



**REFUSE CORPORATION**  
 P.O. Box 31151 • Honolulu, Hawaii 96820-1151  
 Telephone: (808) 839-0855 • Fax: (808) 841-3996

**SERVICE AGREEMENT**

NEW ACCOUNT       CHANGE  
 CUST. P.O. \_\_\_\_\_  
 ARC ACCT. NO. \_\_\_\_\_  
 APPROVED BY \_\_\_\_\_

CUSTOMER'S NAME KULANA NANI APARTMENTS  
 SERVICE ADDRESS 46-229 Kahuhipa  
 CITY Kaneohe STATE HI ZIP 96744  
 CONTACT Larry Pacheco Apt. #E-101 PHONE 247-6630 FAX \_\_\_\_\_  
 CUSTOMER'S BILLING NAME CHANEY, BROOKS & CO.  
 BILLING ADDRESS 606 Coral Street  
 CITY Honolulu STATE HI ZIP 96813  
 CONTACT MR. KEITH K.T. CHING PHONE 544-1886 FAX 544-1672

Contractor agrees to provide the following service and equipment at the frequency of collection indicated.  
 Customer agrees to accept this service at the prices indicated in the schedule of charges provided below in accordance with the terms and conditions specified on the reverse side of this form.

QUANTITY	CAPACITY (CUBIC YDS)	CONTAINER						TYPE		FREQUENCY	
		LOCK	PLASTIC	OPEN	CARTERS	RECYCLED	OTHER	WASTE	RECYCLING	ON CALL	DAYS/ WEEK
4	5CY		X			NO		X			3X

**SCHEDULE OF CHARGES**  
 (Complete applicable items)

Service Charge: Per Month	\$ 1725.00
On-Call Basis	\$ _____
Extra Service	\$ _____
Recycle Service	\$ _____
Equipment Charge/ Rental	\$ _____
Locking Mechanism	\$ _____
Other	\$ _____
Current Landfill Fee (Per Ton)	\$ _____
4.166% State Tax	\$ 71.85
<b>Total Monthly Charges</b>	<b>\$ 1796.86</b>

DESCRIPTION:

QUANTITY	CAPACITY (CUBIC YDS)	EQUIPMENT	COMPACTOR	BALER	OTHER

Description of Service/Equipment/Special Instructions  
 Collection of refuse shall be in strict accord with all applicable rules, regulations, and codes of the City & County of Honolulu, State, and Federal Agencies.

SCHEDULE OF SERVICE	MON	TUE	WED	THUR	FR	SAT	TOTAL
Waste	X			X		X	3X

Effective Service Date: 2/1/98  
 Equipment Delivery Date: \_\_\_\_\_

The terms and conditions on reverse side are part of the agreement.

CUSTOMER: Kulana Nani Apartments  
 PRINT NAME Chaney, Brooks & Co.  
 PRINT NAME Managing Agent  
 AUTHORIZED SIGNATURE Keith K.T. Ching  
 Keith K.T. Ching 17/10/98

ALII REFUSE CORPORATION:  
 PRINT NAME Michael K. Goya  
 AUTHORIZED SIGNATURE Michael K. Goya  
 President 12/11/97



2250 Alshao Place, 2nd Floor, Honolulu, HI 96819 • Telephone (808) 345-0208 • Fax (808) 841-1574  
PC 7388

Page 1 of 2 Pages Exhibit 3

# Proposal

PROPOSAL SUBMITTED TO:	DESCRIPTION OF JOB:
Westlake Apartments c/o Cheney, Brooks & Company Attention: Brad	Westlake Apartments - Pest Control Address: 3139 Ala Ilima Street City: Honolulu, Hawaii Phone: 839-2027 Date: August 31, 1998

We hereby submit quotations and estimates for:  
 (1) Interior treatment to tenant's units for the control of roaches and ants will be done with a residual pesticide to cracks and crevices and electrical outlets. Baits and gel will be used where roaches and ants have been seen traveling. A 30 day warranty is included with this treatment. Any additional treatment done during the warranty period will be done at no additional charge.

Our prices will be:

(A) 12 units per floor \$402.00 tax included.

(B) \$402.00 per floor X 8 floors = \$3216.00 tax included.

Minimum of 12 units or one floor to be treated per day.

NOTE: Tenants to remove all items from cabinets and drawers in kitchen & baths.

Kitchen counters & sink areas should be kept clean and free from food particles. Trash containers should have covers. Sanitation is an important

part of Integrated Pest Management.

We hereby propose to furnish labor and materials complete in accordance with the above specifications for the sum of \$ 3216.00

With payment to be made as follows: Progress billing - net 30 days

All material is guaranteed to be as specified. All work is to be completed in 7 work months unless otherwise specified. Any alterations or omissions from these specifications involving extra costs will be required only upon written order, and will become an extra charge over and above the estimate. All payments requested upon work, schedule or delays beyond our control. Owners to carry fire, tornado and other necessary insurance. Our workers are fully covered by workers' compensation insurance.

Authorized Signature: Robert H. Kaul

Note: This proposal may be withdrawn by us if not accepted within 30 days.

**Acceptance of Proposal** - The above prices, specifications and conditions are satisfactory and are hereby accepted. You are authorized to do the work as specified. Payment will be made as outlined above.

Signature: \_\_\_\_\_

Signature: \_\_\_\_\_

**ENVIRON CONTROL, INC.**  
 Termite and Pest Management  
 2250 Alaha Place, 2nd Floor • Honolulu, HI 96819 • Telephone (808) 845-0008 • Fax (808) 841-1574  
 PC #938

(808) 141-1674 P.03  
 Page 2 of 2 Pages Exhibit 4

# Proposal

PROPOSAL SUBMITTED TO:	DESCRIPTION OF JOB:
Westlake Apartments c/o. Choney Drops & Company Attention: Brad	Job: Westlake Apartments - Pest Control Address: 3139 Ala Ilima Street City: Honolulu, Hawaii Phone: 839-2027 Date: August 31, 1998
We Herby Submit specifications and estimates for (2) Treatment to common areas - office, laundry, 2 workshops, trash bins and sidewalk areas to be done with a residual pesticide for the control of roaches and ants.	
Our prices will be:	
(A) Initial treatment	\$380.00 tax included
(B) Quarterly treatment	\$310.00 tax included
NOTE: No treatment to trash chutes - completely sealed off.	
Prices protected for one year, if accepted within 30 days.	

We Herby Propose to furnish labor and materials complete in accordance with the above specifications, for the sum of \$1310.00

With payment to be made as follows Net 30 days.

All material is guaranteed to be as specified. All work is to be completed in a workmanlike manner according to standard practices. Any alteration or deviation from above specifications involving extra costs will be charged only upon written order, and will become an extra charge for cost and above the estimate. All agreements, conditions, terms, and conditions of this proposal are hereby accepted. Payment will be made as outlined above. Our workers are fully covered by workers' compensation and liability insurance.

Authorized Signature: [Signature]  
 Note: This proposal may be withdrawn by us if not accepted within 30 days.

**Acceptance of Proposal** - The above prices, specifications and conditions are satisfactory and are hereby accepted. You are authorized to do the work as specified. Payment will be made as outlined above.

Date Accepted: \_\_\_\_\_ Signature: \_\_\_\_\_