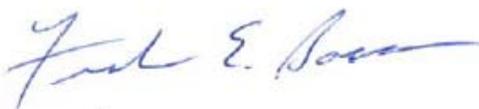




Issue Date	May 11, 2006
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Audit Report Number	2006-FW-1010
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TO: Raynold Richardson
Director, Multifamily Housing Program Center, 6EHM

FROM: 

Frank E. Baca
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: Deer Creek Apartments', Houston, Texas, Previous Management Agent Paid
Itself Unsupported Fees

HIGHLIGHTS

What We Audited and Why

We conducted a review of Deer Creek Apartments (project), a Section 221(d)(4)-insured multifamily housing project, to determine whether the project's owner complied with the regulatory agreement and U.S. Department of Housing and Urban Development (HUD) regulations.

What We Found

The project's owner generally complied with the regulatory agreement and HUD regulations; however, the previous management agent paid itself \$24,312 for unsupported expenses due to weak procurement procedures.

What We Recommend

We recommend that the director of HUD's Multifamily Housing Program Center require the owner or its prior management agent to either provide documentation to show the charges were for actual work performed and that the fees charged were reasonable and necessary or repay the expenses to Deer Creek Apartments. We further recommend that HUD determine whether the prior management agent charged other HUD-insured projects for these unsupported fees and if so, require that the same documentation be provided or the fees be repaid for these projects as well.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft to the auditee on April 5, 2006. The auditee's comments were due on April 21, 2006. On April 20, 2006, the auditee requested an extension to respond until May 12, 2006. We approved an extension to April 28, 2006, since we had previously discussed the finding with the auditee during the audit. The auditee responded on April 28, 2006, and disagreed with the conclusions in the report. We stand by our finding. Further, HUD's Office of Multifamily Housing agrees with our position and has taken steps to seek recovery of the funds. However, we made a clarification in the background section of the report. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Deer Creek Apartments (project) are located at 16303 Imperial Valley Drive in Houston, Texas. PH Deer Creek, LLC, owns the project. Pleasant Hill Community Development Corporation is the nonprofit corporation that owns PH Deer Creek, LLC. In April 2002, PH Deer Creek, LLC (owner), purchased and began renovating the apartment projects with more than \$7.4 million in financing provided by Davis-Penn Mortgage Company and insured by the Federal Housing Administration of the U.S. Department of Housing and Urban Development (HUD) under Section 221(d)(4) of the National Housing Act.

In November 2001, HUD approved Coach Realty Services (Coach) as the management agent for the project. The owner signed a management agent agreement with Coach to operate the project, and Coach served as the management agent until December 2004. In 2004, while Coach was the management agent, the project became delinquent in its mortgage payments. The independent public accountant's report for the fiscal year ending December 31, 2004, cited the owners for several violations of the regulatory agreement and HUD regulations and poor financial performance.

In January 2005, the owner hired Creative Property Management (Creative) as the management agent. Creative maintains its office and records at 8323 Southwest Freeway, Suite 330, Houston, Texas. The mortgage loan has been in default since October 2004. The objective of this review was to determine whether the project's owner complied with the regulatory agreement and HUD regulations.

RESULTS OF AUDIT

Finding: The Previous Management Agent Paid Itself \$24,312 for Unsupported Engineering Services

Although the project's owner generally complied with the regulatory agreement and HUD regulations, Coach, the previous management agent, paid itself \$24,312 for unsupported engineering services. Coach made the unsupported payments because it was unaware of HUD's requirements. As a result, the project may have spent at least \$24,312 for unreasonable or unnecessary services obtained on less than advantageous terms.

Unsupported Engineering Fees

Coach paid itself a \$1,013 monthly fee from the Deer Creek operating account for engineering services that it could not support and which it improperly procured. The engineering services consisted of using the specialized knowledge of a Coach employee and purchasing major equipment necessary to reduce major maintenance costs at several projects owned by the parent company of the owner. Over the two-year review period, these unsupported services totaled \$24,312. Coach agreed in its management agent certification to HUD to ensure that all expenses of the project were reasonable and necessary, on terms most advantageous to the project, and to obtain cost estimates and maintain copies of such documentation. However, it could not provide documentation to show that actual services were provided or that the fees charged were reasonable and necessary. Further, HUD's Management Agent Handbook required Coach to procure services after "soliciting 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." HUD's handbook also required Coach to retain documentation of all bids for three years following the completion of the services. However, Coach could not provide bids or a written contract with the apartment owner for the engineering services performed; nor did it have time sheets, work orders, or written job descriptions to support these charges. As a result, Deer Creek Apartments may have spent at least \$24,312 for unreasonable or unnecessary services obtained on less than advantageous terms.

Coach stated it was not aware of HUD's requirements for bids and a written contract. Further, Coach said it believed it was providing a service that was cost advantageous to the apartment complex, and that it had the verbal permission of the owner to provide the services. Coach should either provide documentation to

show the \$24,312 it received was for actual services performed or repay those fees to the Deer Creek Apartments. Because Coach also managed several other apartment complexes owned by Pleasant Hill Community Development Corporation, it may have unsupported fees at the other projects as well. We did not recommend that Coach modify its procurement procedures because Coach no longer manages HUD properties in the Houston field office portfolio.

Conclusion

Except for the unsupported engineering services, our review did not disclose any evidence of regulatory violations, unauthorized distributions not previously disclosed by the independent public accountants, or loans to other properties. We also determined that the apartments were in generally good condition, needing only minor routine repairs.

Recommendations

We recommend that the director of HUD's Multifamily Housing Center

- 1A. Require the owner or its prior management agent, Coach, to either provide documentation that shows that engineering services were provided and fees charged were reasonable and necessary, or repay the \$24,312 fees Coach paid itself to the Deer Creek Apartments' operating account.
- 1B. Determine what other HUD-insured projects this management agent has operated and whether those projects were charged for unsupported engineering fees. If the management agent charged other projects for unsupported engineering fees, HUD should require the owner or Coach to either provide documentation to support the engineering fees paid or repay the fees to the projects' operating accounts.

SCOPE AND METHODOLOGY

We conducted the review at the offices of the current and previous management agents and the local HUD office in Houston, Texas. Our review period was from January 1, 2003, to December 31, 2005. We expanded the review period to 2002 to review payments made to an identity-of-interest construction company. During the review, we performed the following steps:

- Reviewed background information and the criteria that control the insured multifamily housing project.
- Reviewed various reports, databases, and documents to determine existing conditions at Deer Creek Apartments. The data included independent public accountant reports for fiscal years 2003 and 2004, information contained in HUD's Real Estate Management System, and documents maintained by the multifamily project manager assigned to monitor the project.
- Physically inspected a sample of apartment units and the common areas in the apartment complex to determine the project's overall physical condition.
- Reviewed disbursements and deposits in the accounting records and their supporting documentation to determine whether they appeared appropriate and whether potentially fraudulent activity existed.
- Reviewed the identity-of-interest construction company's contract and the cost certification audits for the contractor and lender to determine whether payments appeared to be excessive.
- Conducted interviews with staff of the current and previous management agents, the owner, and HUD.

We performed the review at the offices of the current and previous management agents during January and February 2006. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Those policies and procedures that the owner/management agent has put into place to reasonably assure that its accounting system accurately classifies revenues and expenses.
- Those policies and procedures that the owner/management agent has put into place to reasonably protect the owner's equity in the Deer Creek Apartments.
- Those policies and procedures that the owner/management agent has put into place to reasonably protect HUD's interest in the Deer Creek Apartments through compliance with the terms of the various agreements between HUD and the owner and/or the management agents.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

We noted no significant weaknesses in the current management agent's internal controls. However, based on our review, we believe the following item is a significant weakness in the previous management agent's internal controls:

- Coach did not have policies and procedures to ensure it complied with HUD requirements related to procurement and maintenance of supporting documentation.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Unsupported <u>1/</u>
1A	\$24,312

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

	APR-28-2006(FRI) 12:23	(FAX) 713.224.0060	P 002/003
		PLEASANT HILL Community Development Corporation	1510 Pannell • Houston, Texas 77020 ph: 713.224.3232 • fx: 713.224.0060
		<u>AUDITEE COMMENTS</u>	
Comment 1		Contrary to the OIG's assessment, we have complied with the regulatory agreement and U.S. Department of Housing and Urban Development (HUD) regulations. We disagree with the OIG conclusion that the previous management agent made unsupported payments of \$24,312 for engineering expenses due to weak procurement procedures, and that such services were unnecessary or obtained on less than advantageous terms.	
		Contemporaneous with this letter response to the audit, we have submitted explanation and documentation for the charges in question which show the charges were for reimbursement of direct employee costs and that the expenses were necessary and reasonable.	
Comment 1		The results of the Audit indicated that the \$24,312 charges were for Unsupported Engineering Services. This is a mischaracterization of the charges. The charges were for direct reimbursement of payroll expenses for a salaried employee who provided on-site services on a part-time basis. Based upon the obvious misstatements contained in the audit, it has become apparent that the salary should have been coded as a project salary expense and not as a reimbursement. Had the corrective action to properly code the accounting entries been taken, it would be clear that the expenses were not subject to the procurement procedures cited, were both reasonable and necessary, and are supported.	
Comment 2		The Audit Report also indicated that the public accountant's report for the fiscal year ending December 31, 2004 cited Coach for several violations of the regulatory agreement and HUD regulations and poor financial performance. This statement is not consistent with the actual verbiage contained in the independent auditor's report. The auditor did not cite Coach for any violations nor did it blame Coach for the project's poor financial performance.	
Comment 3		The Audit Report repeatedly stipulates that Coach paid itself for Unsupported Engineering Services. Coach never provided "Engineering Services" and we do not know how this misrepresentation made its way throughout the report. The \$1,013 monthly charge was not a fee for engineering services. It was reimbursement for salary expense for an employee directly assigned to perform on-site repair, maintenance and other related duties for the project. While it may have been less confusing if the accounting entry had been coded to salary and not reimbursement, an audit adjustment booking this correction eliminates the audit finding. Furthermore, Coach has provided payroll documentation and backup for the employee.	
Comment 1		Since the expenses in question were for a direct project employee, they are not subject to the cited "HUD Management Agent Handbook" requiring Coach to procure services after "soliciting written cost estimates from at least three contractors or suppliers for any	
		<hr/> Mission Statement <i>Recognizing the needs of suffering humanity, PHCDC develops and provides innovative programs with a focus on spirituality and comprehensive community revitalization.</i>	

Comment 4

contract, ongoing supply, or service which is expected to exceed \$10,000 per year. All of the Audit Report's references to procurement, bids, etc are not applicable in this case.

The OIG denied our request for a longer extension in order to provide sufficient time for us to gather and review all of the documentation with the OIG that would show these cost to be justified. Since the OIG elected not to provide sufficient time to submit and review this important information, their report is neither fair nor accurate.

MISSION STATEMENT

Recognizing the needs of suffering humanity, PHCDC develops and provides innovative programs with a focus on spirituality and comprehensive community revitalization.

**COACH REALTY SERVICES, INC.
JOB DESCRIPTION**

**PROPERTY MAINTENANCE DIRECTOR
PAUL MARTINEZ**

Comment 1

The purpose of this position is to provide oversight, direction, support, and on-site assistance for all property repair and maintenance activities for owners of property in the Coach Management portfolio. This position functions as a part of the onsite team to maximize repair and maintenance effectiveness and to minimize repair and maintenance expense. The objective of this position is to work closely with property managers and maintenance personnel to keep each property in the best physical operating condition possible with the limited financial resources available.

The specific duties of this position include:

- Daily oversight of the assigned properties. This will be done on a rotating basis to insure that each property receives adequate attention and on an as needed basis for property emergencies.
- Direct and supervise onsite maintenance personnel in accomplishing specific repairs.
- Rolling up the sleeves and working with property maintenance to accomplish timely repairs.
- Review of maintenance needs with Property Manager to prioritize repairs and advise on most effective economical methods of accomplishing.
- Help identify and retain the best available third party vendor(s) to provide repair or maintenance for tasks beyond the abilities of onsite staff.
- Routinely inspect each property with the Manager to identify areas needing maintenance attention and give input to the manager in creating a cost estimate for each repair.
- Routinely inspect each properties maintenance shop for safety, organization and proper storage and labeling of chemicals and materials.
- Actively recruit, interview and recommend for hire individuals for maintenance positions.
- Critique and review the performance of maintenance personnel with the Property Manager to identify areas of strength and weakness.
- Train maintenance personnel in methods and techniques to better accomplish their specific job duties. Recommend third party training classes that would be beneficial for the employee and the property.
- Accompany and assist with property inspections as needed by insurance providers, investors, owners and lenders. Oversee correction of noted deficiencies in cooperation with the Property Manager.
- Be available on call 24 hours a day to deal with emergency situations.

This position is salaried and reports to the Vice President of Property Management while working closely with and being responsible to each Property Manger.

COACH REALTY SERVICES, INC.
Office Memo

Comment 4

To: Whom It May Concern
From: Donna Lawson, Payroll Administrator
Date: 04-25-06
Subject: Paul Martinez

This memo is confirmation that Mr. Paul Martinez was employed as a salaried, exempt employee of Coach Realty Services, Inc. during the 24 month period from January 1, 2003 thru December 31, 2004.

Mr. Martinez was employed as Property Maintenance Director and was charged with on site responsibilities on properties owned by Pleasant Hill CDC per his job description.

During this period of time, Mr. Martinez salary was split between the properties he oversaw and worked on based on a price per unit basis of \$40 per unit per year.

Donna Lawson

OIG Evaluation of Auditee Comments

- Comment 1** The response disputed the charges were for unsupported payments and indicated the charges were for direct reimbursement of payroll expenses of a salaried employee. The response provided backup documentation for the employee's position. We disagree with the response and stand by our original conclusions. Further, the additional information provided indicates that the employee was a supervisory employee whose salary should not have been paid from the project's operating funds, but should have been covered by the management agent's fee.
- Comment 2** The response asserted the public accountant's report did not state that Coach had violated the regulatory agreement nor was it responsible for the project's poor financial performance. We clarified in our report that the owner, PH Deer Creek, LLC, and its sole member, Pleasant Hill CDC, were the entities the independent auditor's report cited for violations of the regulatory agreement and poor financial performance. However, Coach, as the management agent, was responsible for the daily management and maintenance of the project during the period when the findings occurred.
- Comment 3** The response stated Coach had never provided "Engineering Services." The term "Engineering Services" is the name that Coach used in its general ledger account for the \$1,013 monthly charge. Coach also used the terms "Engineering fees" and "ENG FEE" to describe the individual transactions in the general ledgers and "Engineering Services" as a vendor account label in its check register.
- Comment 4** The response stated the auditee did not have sufficient time to gather and review all documentation to respond to the audit. We originally presented our finding to Coach on February 16, 2006, and gave it a chance to provide information to refute our conclusion. Since Coach was previously unable to provide documentation to support the fees and the response included information dated April 25, 2006, to support expenses paid by the project in 2003 and 2004, we question whether any contemporaneous documentation exists.