



U.S. Department of Housing and Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

District Inspector General for Audit

December 30, 1996

**Audit Related Memorandum
No. 97-PH-212-1802**

MEMORANDUM FOR: Charlie Famuliner, Director, Multifamily
Division, Virginia State Office, 3FHM

FROM: Edward F. Momorella, District Inspector General
for Audit, Mid-Atlantic, 3AGA

SUBJECT: Chesterfield Square Mutual Homes, Inc.
Mortgagor Operations
Richmond, Virginia

Pursuant to your request, we have completed a review of project operations for Chesterfield Square Mutual Homes, Inc. Your request identified questionable transactions and indicated potential mismanagement of project affairs by the Management Agent (Agent).

The purpose of our review was to determine if the project was operated in accordance with the terms and conditions set forth in the Regulatory Agreement and applicable HUD directives.

We reviewed project records and reports, analyzed cash disbursements and reserve account activity, performed on-site testing of tenant housing assistance eligibility, and examined the preparation of the annual budget. We interviewed Asset Management Branch staff in your office and project personnel.

Results of Review

Our review disclosed the following:

- Evaluation of expenditure documentation from June 1993 to May 1996 showed that project funds totalling \$4,175 were used to pay health insurance premiums for a non-employee painting contractor. This improper procedure was permitted by the Agent. The contractor made periodic payments and reimbursed the project \$4,020. The contractor, who relocated out-of-state, still owes the project \$155.

- Expenditure documentation supports the reasonableness of the project's \$11,200 purchase of the Agent's personal truck in 1993. No evidence was found to indicate that the purchase was other than necessary to meet project requirements, and approved by the project's Board of Directors.
- Expenditures may not have been made at the lowest possible cost to the project. Contrary to provisions contained in the Housing Management Agreement, written cost estimates from three sources were not always obtained for project expenses valued at \$5,000 or more. In addition, documentation was not available to show that verbal and written quotes were solicited to validate the reasonableness of costs for ongoing supply or service requirements valued at less than \$5,000 as required by the Management Agreement and the Management Certification.
- Required reserve deposits were made, reserve account levels were maintained, and disbursements from reserve fund accounts were proper. However, as of November 20, 1996, excess cash amounting to \$107,425 was contained in the project's reserve accounts. The Agent maintained an unneeded painting reserve fund, valued at \$65,792. The Agent also held earned interest in the membership trust and general operating reserve accounts, totalling \$36,252 and \$5,381, respectively. The Agent stated that these accounts were used to hold excess cash to preclude residual receipts identification and restriction, and to maintain control over the funds. The Regulatory Agreement requires that any residual receipts realized from property operations be deposited into the reserve fund for replacements and shall at all times be subject to HUD's control.
- The Fiscal Year 1996 and 1997 annual budgets were not properly prepared, overstating project expenses by \$21,036 and \$28,788, respectively. The Agent overstated the budgeted expense for the reserve fund for replacements deposit requirement by the amount of planned interest to be earned on the account. The Agent stated that the interest amount was added to the expense in order to offset the income since it was restricted and not readily available for project use. According to the Regulatory Agreement, housing charges shall be in amount sufficient to meet the estimated expenses set forth in the operating budget. Ownership should revise the current budget and eliminate overstated expenses.

- In coordination with the HUD Office of the Inspector General for Investigation, we determined that the Agent was the subject of an investigation involving another HUD project. As a result of the investigation, the Agent was convicted of fraud in June 1996 in connection with his position as managing agent for the other project. Because of this conviction, HUD has suspended the Agent from participation in procurement and non-procurement transactions as either a participant, principal, or contractor with HUD. Additionally, HUD is considering debarring the Agent for a three year period.

Recommendations

We recommend the owner:

- 1A. Obtain from the Agent the \$155 owed the project on the painting contractor's health insurance premiums.
- 1B. Assure that project expenditures are obtained at the lowest possible cost by enforcing the provisions of the Housing Management Agreement.
- 1C. Close the painting reserve account. Transfer the account's balance and the excess funds contained in the membership trust and the general operating reserve accounts to the reserve fund for replacements account.
- 1D. Revise the FY 1997 operating budget and eliminate overstated expenses.
- 1E. Evaluate the Agent's suspension and proposed debarment by HUD. Determine its impact on the current management agreement and take whatever action deemed necessary.

The results of our review were discussed with the project's Board of Directors and your staff.

Should you have any questions please contact Irving I. Guss, Assistant District Inspector General for Audit at (215) 656-3401.

Attachment - Distribution

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REPORT NAME: Chesterfield Square Mutual Homes, Inc.
 Mortgagor Operations
 Richmond, Virginia

REPORT NO: 97-PH-212-1802

ISSUE DATE: December 27, 1996

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