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Audit Case Number	97-AT-211-1004

TO: Martha A. Littlefield, Director, Office of Housing, Jacksonville Area Office, 4HH

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Cooper-Holt Manor
Project No. 063-35165
Multifamily Rental Housing Mortgage Insurance Program
Jacksonville Beach, Florida

We tested books and records of The Beaches Hamlet LTD, d/b/a Cooper-Holt Manor, to determine whether selected project activities and expenditures complied with HUD requirements. The managing general partner mismanaged project operations by disregarding Regulatory Agreement and other U.S. Department of Housing and Urban Development (HUD) requirements. We identified ineligible and unsupported expenditures of \$220,318 and \$37,824, respectively.

* * * * *

Within 60 days, please give us, for each recommendation in the 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. Also, please furnish us copies of any correspondence or directives issued because of the audit.

If you have any questions, please contact Ted Drucker, Assistant District Inspector General for Audit, at (404) 331-3369 or Sam Daugherty, Senior Auditor, at (904) 232-1226.

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Executive Summary

We have completed a limited audit of Cooper-Holt Manor to determine whether selected project activities complied with HUD requirements. We found ineligible costs totaling \$220,318 and unsupported costs of \$37,824 leading us to conclude that project operations were mismanaged. Summaries of the larger dollar instances follow:

- Between 1984 and 1986 project funds paid investor servicing fees of \$35,718. The fees protected limited partners' interests, and did not benefit project operations.
- The partner took \$32,123 as a management fee during 1987 when the project had a contract with a management agent. The Regulatory Agreement prohibits the partner from receiving any compensation from project funds without HUD's prior written permission.
- Project funds totaling \$9,539 were used between 1986 and 1993 for legal expenses unrelated to project operations.
- The partner received salary and a two bedroom rent-free unit. Her compensation totaled \$64,620 for 1992 through May 1996. Also, lost project revenue for the rent-free unit was \$19,968 from December 1, 1993 through August 31, 1996.
- Project funds of \$13,262 paid for truck costs which were unnecessary and/or excessive for project operations.
- The partner's two sons were paid for project maintenance and security. The project had no time sheets available for the maintenance supervisor (son #1); work orders indicate the maintenance assistant completed most of the work. The maintenance supervisor received an annual salary of \$27,040. We also question the payments for security to son #2 because no time sheets or emergency work orders supported work. During our review period son #2 received \$10,784, and a rent free unit valued at \$7,320 annually to monitor the emergency alarm system while a vendor was under contract to monitor that system.
- An identity-of-interest between the management agent and the partner was not adequately disclosed in the management certification and audited financial statements. The management agent hired the partner as the project's social services director, and paid her 30 percent of the management fee, or a total of \$32,411 from January 1994 through May 1996.

As a result, the project was not operated efficiently or cost-effectively. Therefore, we are recommending the HUD Jacksonville Area Office (JAO):

- Consider administrative sanctions against the partner and remove her from day-to-day project operations.

- Demand repayment of ineligible and unsupported expenditures and lost revenue.
- Instruct the mortgagor to submit time sheets, work orders, and invoices supporting compensation paid to the maintenance supervisor and the after hours maintenance/security person, or also repay amounts unsupported as being reasonable and essential for project operations.

We discussed the issues with project's management during the audit and at an exit conference held on January 15, 1997. Auditee comments are summarized in the findings. The draft findings were provided to the partner and her responses were considered in this final report. Auditee responses of 34 pages, were rubber-stamped "confidential" and referred in part to allegations and collateral subjects. Therefore, we are separately furnishing them to the addressee of this report.

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Abbreviations

HUD	U. S. Department of Housing and Urban Development
JAO	HUD Jacksonville Area Office

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Introduction

Cooper-Holt Manor project, located at 1600 Shetter Avenue, Jacksonville Beach, Florida, is a multifamily housing development insured under Section 221 d(4) of the National Housing Act. The project has 104 units, all of which are eligible for Section 8 assistance under Housing Assistance Payments contract No. FL29-H122-004. The Beaches Hamlet LTD, a limited partnership, owns the project and has two general partners, Arlene M. Cooper and Edward Holt. Ms. Cooper has been designated as the managing general partner. On October 17, 1979, the owners and HUD executed a Regulatory Agreement in which the owners agreed to comply with the agreement terms and other HUD requirements.

Keystone Properties, Inc. was hired in 1993 as the management agent to supervise the project's day-to-day operations. Prior to Keystone, Rimsco Inc. was the management agent. The project staff included the partner and her immediate family. The maintenance supervisor and the after hours maintenance/security person were sons of the partner, and the office manager was her daughter-in-law (maintenance supervisor's spouse). In addition to being the social services director, the managing partner was on-site manager.

AUDIT OBJECTIVE, SCOPE AND METHODOLOGY

The purpose of our limited audit was to consider whether selected project activities complied with HUD requirements, and whether related project expenditures were reasonable and necessary. Our audit generally covered the period of January 1, 1995 through May 31, 1996; however we reviewed other periods as necessary to define the issues.

We conducted the audit at the project site, and Keystone's office located at 243 Arlington Road N., Jacksonville, FL. Project financial records were at the Keystone office; tenant files, rental receipt information, and work orders were at the project site. Our main contacts for the audit were Ms. A. Cooper and Mr. Ronald Knee of Keystone.

We performed audit work from July 1996 to January 1997.

We reviewed the Regulatory Agreement, Management Agreement, management plans, applicable HUD Handbooks, correspondence between HUD and the project, and the project general ledger for the audit period. We interviewed the partner, HUD, and Keystone staff.

Our audit included, but was not limited to, a review of the following:

- Cash Disbursements and Payroll
We tested petty cash accounts and selected general ledger accounts. The accounts reviewed included building equipment, maintenance equipment, repair material, janitor/cleaning supplies, and office and manager salaries.

- Distributions to Partner and Surplus Cash
We reviewed distributions since 1987, and surplus-cash calculations from 1990 to 1996.
- Cash Receipts
We tested cash receipts from rents and miscellaneous sources with emphasis on the 2 months of December 1995 and January 1996.
- Occupancy
We reviewed a judgmental sample of prior and current tenant files to consider whether tenant information was properly evaluated.
- Work Order System
We interviewed project staff and reviewed work orders to consider the support for project maintenance changes.

We conducted our audit in accordance with generally accepted government auditing standards.

Project Operations Were Mismanaged

The managing partner mismanaged project operations by having project funds paid to her, on her behalf, and to her relatives. She disregarded the owners' contract with HUD (Regulatory Agreement) and other requirements. As a result there were ineligible expenditures and lost project revenues of \$220,318, and additional unsupported expenditures of \$37,824. We believe that she should reimburse project funds which she used for other than reasonable and necessary project purposes.

According to the Regulatory Agreement, the mortgagor shall not, without the prior written approval of the Secretary: (1) assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds, except from surplus cash, except for reasonable operating expenses and necessary repairs, or (2) make, or receive and retain, any distribution of assets or income except surplus cash.

Our review disclosed the following problems:

1. Between 1984 and 1986, project funds paid investor servicing fees of \$35,718. These fees protected limited partners' interests, and did not benefit project operations. On April 20, 1988, the JAO advised the owner that payment of investor servicing fees with project funds violated the Regulatory Agreement, and required repayment. The owner, through the management agent, advised they were attempting to sell the project and were being sued for outstanding investor servicing fees. The owner acknowledged the \$35,718 debt, and requested delay of repayment until disposition of the property and resolution of the lawsuit. We found no documentation indicating HUD's approval. Subsequently, the purchase agreement was terminated (September 6, 1988) and the lawsuit was settled (March 5, 1992). The \$35,718 had not been repaid.

The owners provided a HUD memo which they believe provides HUD's written permission to delay repayment until the property was sold at any future sale. We reviewed the subject memo, HUD's file for related documentation, and discussed this issue with JAO officials. We conclude HUD's determination related to the potential sale at that time and not any future sale.

2. The partner received \$32,123 in 1987 as a management fee. We asked what service by the partner entitled her to this fee. She advised the project partnership agreement provided a 6 percent fee could be paid to the partner for leasing and management of the project operations. Since the amount paid the management agent was less than 6 percent, she received the difference. She believed HUD approved the fee because the partnership agreement was provided to the JAO for review and approval.

Although the partnership agreement provided a partner may receive payment for services, the Regulatory Agreement requires prior written approval. We found no such approval.

3. The project paid legal expenses of \$9,539 unrelated to project operations between 1986 and 1993. A review conducted by the JAO and our review of invoices for legal services disclosed fees included defending the partnership (\$4,442), other general partnership matters (\$2,938), management agent's responsibility (\$1,932), and a Writ of Garnishment (\$227). At various times from 1995 to 1996, the JAO requested reimbursement of these fees to the project's operating account. The partner did not comply. The partner stated the partnership was responsible for any lawsuits brought against it. The only funds available were from operating income. However, matters related to partners' interests do not constitute eligible project costs.
4. The partner as the on-site manager received salary and a two-bedroom rent-free unit with utilities. Compensation to the partner from project operations totaled \$64,620 for the period 1992 through May 1996. Lost project revenue from the rent-free unit (without considering utilities) was \$19,968 for the period December 1, 1993 through August 31, 1996.

The partner stated her duties included supervising on-site staff (generally her sons and daughter-in-law), answering phones when the office manager was unavailable, monitoring emergency alarm system, and giving out work orders. Based on our interview and observations of her duties, the office manager (partner's daughter-in-law) provided site management and occupancy needs such as conducting tenant selection, completing occupancy certifications and recertification, and taking maintenance requests. In our opinion, the office manager also could perform the partner's project duties.

In general, maintenance staff are required to handle emergency calls as part of their responsibilities. Beeper services were already included in project operations. A contractor monitored the emergency alarm system.

As a result of a 1994 monitoring review, HUD's contract administrator specifically advised the partner to terminate her involvement in the day-to-day operations. During our review, the management agent advised he did not believe there was a concern as long as the owner's service related to project operations. We disagree. When the owner is involved, the Regulatory Agreement provisions applies and prior written consent must be obtained from HUD. The partner advised HUD approved the limited partnership agreement prior to closing the loan, wherein the partners agreed the partner could receive fees for services in the management and leasing of the project.

The JAO reviewed the partnership agreement for language related to selected topics, which did not include whether partners can receive compensation from operations. However, one provision in the partnership agreement that JAO required was a statement the Regulatory Agreement would prevail if the partnership agreement contained a conflicting provision(s). Although the partnership agreement provides a partner may receive payment for services, the Regulatory Agreement requires prior written approval from HUD. Accordingly, prior written permission should have been obtained.

The partner was not approved by HUD to receive operating funds as compensation, but received \$64,620, which should be reimbursed to the project. Further, the lost revenue of \$19,968 related to the partner's rent-free unit also should be reimbursed to the project.

5. Project funds paid for partner's son's used truck. The truck had been purchased by the maintenance supervisor (partner's son) and spouse in 1994. On June 1, 1995, the partner signed an agreement with the spouse whereby the partnership took over payments (of about \$410 per month for 29 months) and also paid \$3,000 in cash, or a total of \$14,882. Only four monthly payments remained to be made at June 30, 1997, making direct project expenditures of \$13,262 at June 30 for the truck.

Title to the truck remained in the names of the partner's son and daughter-in-law. The project's interests were not protected, and its need for the vehicle had not been established. The partner's son appeared to primarily use the truck for unrelated purposes, including driving it home daily. He confirmed he took the truck home after work, and justified his non-project use of the truck because he occasionally paid for gas. Generally, taking home a project-owned vehicle occurs when an employee is required to respond to after-hour emergency calls, not for convenience. The partner advised the duties also included emergency calls on week ends. We found no support the maintenance supervisor answered emergency calls. Therefore HUD should require the partner to repay the project all related amounts, including principal, interest, fuel, insurance and other expenses for the truck.

6. Project funds paid for partnership expenses. The Internal Revenue Service assessed a late fee of \$1,513 against the partnership for not filing the 1994 tax returns timely, which was paid in August 1995 from project funds. Timely tax filings are the responsibility of the partnership, not the project.
7. Payments made for partner's medical coverage. Project funds in August 1995 paid the partner's medical bill totaling \$177. The partner advised she had instructed the managing agent to provide her with the insurance all employees had, but found that he had not done so. Therefore, she submitted the bill to the management agent for payment.

In addition for 1995 and 1996, the partner instructed the management agent to pay her the amount saved by her not participating in the employee's group health insurance program. The management agent paid her \$3,687 from project funds. Payments to an employee for not participating in a health insurance program are unreasonable and unnecessary expenses. Accordingly, the funds should be reimbursed.

8. The partner received \$32,411 from the management agent for project social services during January 1994 through May 1996. After Keystone's management agent contract became effective, the partner and Keystone entered into a separate agreement in which the partner would be the exclusive social service director at Cooper-Holt Manor. In return, the partner received 30 percent¹ of the management agent's fee. The arrangement was not disclosed by either partner or Keystone to HUD in the management agent's certification process or subsequent financial statement disclosures regarding related party transactions. These Keystone payments to the partner were really kickbacks of a portion of the management fee being paid by the project and are ineligible.

The management certification requires the owner and management agent to disclose any identity-of-interest among the owner, agent, and any individual or companies that regularly do business with the project. The participation of the partner as a paid social service director, receiving 30 percent of the management agent's monthly fee, was not disclosed. Also, the owner was required to disclose all related party transactions in the annual audited financial statements. We found inadequate disclosure of the subject relationship.

The management agent advised he reviewed the identity-of-interest definition in HUD's handbook, and believes no identity-of-interest exist within that definition. We disagree. The contract between the partner and management agent was not an arms-length transaction, and the agent shared the management fee with the partner. By doing so, the partner demonstrated undue influence over the management agent and project operations. Specifically, if the partner's social service duties were unacceptable, any attempt to remove the partner from the position could result in the removal of the management agent. Thus, a reportable relationship existed between the agent and partner due to the kickback nature of the payments to the partner.

The management agent also advised he informed the JAO verbally about the relationship. Our discussions with the JAO staff confirmed their awareness. The JAO staff then believed HUD was not concerned about the management agent use of their fee. However, based on the findings in this report, JAO officials have advised they will re-evaluate their assessment.

¹ The agreement between the partner and Keystone states one third of the management agents' fee is to be paid to the partner. According to Keystone, this was changed to 30 percent.

Based on these facts, we believe the partner should not continue as social service director because the management agent was placed in a position that the partner, who hired him, was now his associate.

9. The partner's two sons received project funds. One son (#1) was paid as the maintenance supervisor, and the second (#2) was paid as contract labor (air conditioning repairs and electrical service) on an as-needed basis. Son #2 was also called the after hours maintenance/security person. The maintenance supervisor received salary and benefits, plus general use of the project truck as discussed previously. Son #2 received \$15 per hour for contract labor, and a rent-free unit with paid utilities for after-hour maintenance and security. Because they are inadequately supported as being reasonable and necessary project costs, we question as unsupported both the salary of son #1 totaling \$27,040 annually, and payments to son #2 totaling \$10,784 for after hours maintenance and contract labor costs. Also, we believe his rent-free unit was unnecessary for security; annual lost revenue was \$7,320.

The maintenance supervisor's employment costs are not established as being reasonable and necessary project costs. Work orders reviewed indicate most work was completed by the maintenance assistant. Further, no time sheets related to the hours worked were found. Both the management agent and the partner advised no time sheets were maintained. During the exit conference, the partner advised time sheets would be available. The management agent relied on verbal information provided by the partner regarding payroll. Original time sheets, signed by the employee and prepared at the date of being on duty, were needed to support the payments.

The maintenance supervisor advised his responsibility was to supervise the one full time maintenance man and maintain the lawn. Since supervision was the responsibility of the resident manager, supervision by the maintenance person was unnecessary.

The rent-free unit with paid utilities for son #2 was not adequately established as being reasonable and necessary. His contract labor responsibilities included repairs to the air conditioning and other repairs as needed. During our review, we were provided no time sheets and few invoices supporting the \$10,784 paid by the project to son #2 for contract labor and after hours maintenance. His security responsibilities included checking main entrance locks and monitoring the alarm system. We do not believe the security service warranted the rent-free unit. The project already was paying a contractor for monitoring the alarm system. Further, the partner as resident manager advised she was responsible for monitoring the alarm. Occupancy by the son denied tenancy to an eligible low income family. Also, that unit is a two-bedroom unit occupied by a single person. Annual value of the two-bedroom unit was \$7,320.

* * * * *

In summary, the above issues involve misuses of project assets by the partner to benefit her and related-parties. The Regulatory Agreement prohibits compensation to the owner without HUD's prior written permission, other than from surplus cash. No permission from HUD was obtained, and surplus cash at December 31, 1996 was negative (\$49,744), or that much below zero, due in part to the partner's advantage taking. Further, these ineligible and unsupported project payments were not supported as being reasonable or necessary project costs. Accordingly, the partner should not be involved in day-to-day operations, and should repay the project \$220,318 for the ineligible costs, and either justify or repay an additional \$37,824 in unsupported expenditures.

RECOMMENDATIONS:

We recommend you have the managing partner:

- 1A. Vacate the rent-free unit she occupies, and remove herself from the project's day-to-day operations.
- 1B. Terminate the related party transaction for project social services between the partner and management agent.
- 1C. Repay project operations at least \$220,318 for ineligible costs paid directly or indirectly by the project as follows:

Investor's service fees of \$35,718.

Management fees of \$32,123 paid to the partner.

Legal fees of \$9,539 only indirectly related to project operations.

Payments of \$64,620 for salary and fringe benefits to the partner as the on-site resident manager.

Lost revenue of \$19,968 for the unit occupied by the partner.

All amounts including principal, interest, fuel, and other expenses paid for the truck. (Direct project expenditures of \$13,242 were identified at June 30, 1997)

The Internal Revenue Service late fees of \$1,513.

The partner's medical costs of \$177 and payment to her of \$3,687 in lieu of her participation in the employee's health insurance program.

The \$32,411 and additional amounts since May 1996 in kickbacks she received from the management agent.

The lost revenue of \$7,320 annually related to the unit occupied by son #2.

- 1D. Provide adequate supporting documentation for the \$10,784 paid to son #2, or repay that amount.
- 1E. Provide 1995, 1996, and 1997 time sheets for payroll payments to son #1 of \$27,040 annually, or repay them. These time sheets to be acceptable must be original, and not retroactively prepared.

We also recommend that:

- 1F. You consider administrative sanctions against the partner because of Regulatory Agreement violations.

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Internal Controls

In planning and performing our audit, we considered the project's internal controls in order to determine our auditing procedures and not to provide assurance on the internal controls. Internal controls consist of management's plan of organization, and methods and procedures adopted to insure that resource use is consistent with laws, regulations and policies; resources are safeguarded against waste, loss and misuse; and reliable data is obtained, maintained and fairly disclosed in reports.

SIGNIFICANT CONTROLS

We determined the following internal controls to be relevant to our audit objective:

Accounting Controls:	Accounting records and reports Cash receipts and disbursements.
Administrative Controls:	Compliance with the Regulatory Agreement (Contract) between the mortgagor and other HUD requirements Work order system and timesheets

We assessed the relevant controls listed above.

A significant weakness exists when internal controls do not reasonably assure that: objectives are met; resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports. In our opinion, the following problems are significant, but are not primarily due to flaws in the internal control system:

- The partner ignored or bypassed accounting controls resulting in the ineligible and unsupported project payments previously discussed in this report.
- The partner has a relationship as social services director of the project with the management agent.

Based on our work, we determined noncompliances with HUD requirements as discussed in the audit finding. We believe those problems fundamentally are related to the partner and her multiple roles with the project.

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Follow-Up On Prior Audit

We reviewed the project's audited financial statement for the period covering January 1, 1995 to December 31, 1995, performed by a public accounting firm. The issues presented in our audit finding (relating to ineligible and unsupported project disbursements) were not disclosed.

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Schedule of Ineligible and Unsupported Costs

<u>Recommendation</u>	<u>Ineligible Costs²</u>	<u>Unsupported Costs³</u>
1C	\$ 220,318	
1D		\$ 10,784
1E	_____	<u>27,040</u>
	<u>\$ 220,318</u>	<u>\$ 37,824</u>

² Ineligible costs are not allowable by law, contract, HUD or local agency policies or regulations.

³ Unsupported costs are not obviously ineligible, but warrant being contested for reasons such as lack of satisfactory documentation.

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