



U.S. Department of Housing and Urban Development
District Office of the Inspector General
Office of Audit
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June 1, 1998

No. 98-AT-211-1804

MEMORANDUM FOR: Reba G. Cook, Director, Multifamily Housing Division, 4GHM

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

SUBJECT: Willow Park, Ltd.
Review of Subsidy Calculations and Project Maintenance
Clarksdale, Mississippi

At your request, we conducted a limited review of Willow Park, Ltd. (Mortgagor). The objectives of the review were to determine if the Mortgagor exercised proper oversight of Section 8 subsidy calculations and billings, and complied with requirements for project maintenance.

To accomplish the objectives, we reviewed records at HUD's Mississippi State Office, the office of the Mortgagor's Independent Accountant in Jackson, and the project office in Clarksdale, Mississippi. We also interviewed HUD officials, the Mortgagor General Partner, tenants, and employers/providers of government assistance. We conducted a limited inspection of the project grounds and dwelling units. We used judgmental sampling methods during the review.

We conducted the on-site review from September 1997 through March 1998. The review covered the period January 1, 1993, through June 30, 1997.

BACKGROUND

The Mortgagor built Willow Park Apartments in 1980 under Section 221(d)(4) of the National Housing Act. The project includes 80 units located in Clarksdale, Mississippi. All tenants receive Section 8 rental assistance through a Housing Assistance Payments Contract between the Mortgagor and HUD. The project is managed by Doty, McLaurin & Taylor Management Company, Inc., an identity-of-interest management agent in Jackson, Mississippi.

On April 14, 1997, the Mortgagor informed HUD that the previous project manager may have diverted project funds. The Mortgagor became aware of the possible diversion after the manager's sudden death in March 1997. When the new project manager began collecting rent in April 1997, she noticed that some tenants offered payments which exceeded rent due per project records. As a result, the manager recertified all tenants to establish correct tenant rents and HUD subsidy. The recertifications resulted in substantially less subsidy for a large number of tenants. The Mortgagor General Partner notified the bonding company of a potential claim.

SUMMARY

The review disclosed excessive subsidy payments and a need for the Mortgagor to address deferred maintenance.

The Mortgagor and its identity-of-interest management agent did not exercise proper oversight of the certification and recertification of Section 8 tenants. As a result, they failed to timely detect noncompliances by their project manager with program requirements for calculating HUD subsidy. We computed \$40,817 in excessive subsidy for a sample of five tenants. The excessive subsidy payments occurred because tenant incomes used to calculate subsidies were understated. Verifications of Employment (VOEs) contained incorrect employment or income data or, in some cases, did not exist. The Mortgagor needs to compute and refund to HUD overpaid subsidy, and implement controls over project personnel.

The Mortgagor also needs to address deferred project maintenance in order to provide tenants the quality housing intended by the Section 8 Program and to protect HUD's interest in the insured mortgage.

Details of these issues are in Attachment 1.

We discussed the draft findings with Mr. Arthur W. Doty, General Partner, during an exit conference on March 25, 1998. Mr. Doty agreed to take necessary corrective actions. His written comments are in Attachment 2, and are summarized in Attachment 1 following each finding.

* * * * *

Within 60 days, please furnish us, for each recommendation in Attachment 1, a status report on: (1) corrective actions taken; (2) proposed corrective actions and the date to be completed; or (3) why actions are considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of this review.

We provided a copy of the report to the auditee.

Should you or your staff have any questions, please contact Rudy E. McBee, Assistant District Inspector General for Audit, at (423) 545-4368 or Narcell Stamps, Senior Auditor, at (404) 331-3369.

Attachments:

- 1 - Results of Review
- 2 - Auditee Comments
- 3 - Distribution

RESULTS OF REVIEW

Finding 1 - Inadequate Oversight Resulted in Excessive Subsidy Claims

For several years the Mortgage claimed and HUD paid excessive Section 8 subsidy. Exactly how long the claims occurred and how much excessive subsidy was paid is unknown. For a sample of five tenants, HUD paid \$40,817 in excessive subsidy from about 1994-1997. The project manager understated tenant income used to calculate rents and subsidy, resulting in understated rents and overstated subsidies. We believe subsidy claims for other tenants were also excessive, and recommend the Mortgage recalculate subsidy claims and reimburse HUD for excessive payments. The problem was not detected because the Mortgage and identity-of-interest management agent had not implemented controls to verify the accuracy of calculations.

Owners must verify, in writing directly from the source, all tenant income and other information that affects eligibility or rent, and maintain documentation of all verification efforts for at least three years after the effective date of the certification or recertification (HUD Handbook 4350.3, Occupancy Requirements of HUD Subsidized Multifamily Housing Programs, paragraphs 3-31 and 3-39). The management agent is responsible for calculating rents and subsidy, and for supervising project employees, including the project manager.

We recalculated HUD subsidy for a test sample of five tenants, focusing on the accuracy of tenant income. We selected the five from among 35 tenants whose rent increased, and subsidy claims correspondingly decreased, when the new manager recertified them after the previous manager died in March 1997. Previous subsidy amounts were overstated because tenant incomes were understated. We reviewed prior year certifications or recertifications to determine when the problem first occurred and the total effect on HUD subsidy.

For the five cases, we reviewed all rent calculations by the prior manager from about 1992 until the calculations by the new manager in 1997. We agreed in all cases with the new manager's calculations. However, the prior manager's calculations resulted in excessive subsidy payments of \$40,817 as follows:

<u>Tenant</u>	<u>Excessive Subsidy</u>	<u>Period Claims Were Excessive</u>
A	\$ 5,594	4/01/94 - 5/31/97
B	11,411	1/01/93 - 6/30/97
C	8,921	5/01/95 - 5/31/97
D	10,181	12/01/94 - 6/30/97
E	<u>4,710</u>	4/09/96 - 6/30/97
Total	<u>\$40,817</u>	

The excessive subsidy claims resulted from the prior manager understating tenant incomes. Section 8 tenants are required to pay 30 percent of their income toward rent, net of various deductions and exclusions, and HUD pays the difference in subsidy. When the prior manager understated tenant incomes, tenant required contributions toward rent were understated and the HUD subsidy was overstated.

The five tenants claimed they paid the prior manager more than records showed was owed and collected; however, the tenants did not have receipts or other documentation to support their claims. Project records did not reflect the larger rent payments. Four of the five tenants said they signed the certification or recertification showing the understated tenant income and rent, and overstated HUD subsidy, but they could not recall if the forms contained the incorrect information when they signed them.

The excessive claims for the 5 tenants involved 19 rent calculations, and all 19 were improperly documented with VOEs. Specifically:

- Files for 12 calculations did not contain VOEs. All incomes used to calculate subsidies were understated based on information we verified with employers.
- Files for the remaining seven calculations contained VOEs, but data thereon was incorrect. Four VOEs appeared to be copies of prior verifications of government assistance, altered to show incorrect income. We verified that each of the tenants had employment incomes significantly more than those shown. Another copy of a VOE showed the correct employer, but the form was altered to show the tenant worked less hours than we verified. Two original VOEs had white-out alterations that understated the number of hours worked or the hourly rates paid.

The problems with all 19 calculations examined indicate a likelihood of similar problems with other subsidy calculations by the previous project manager.

The Mortgagor and its identity-of-interest management agent contributed to the problem by not exercising proper oversight of the recertification process. The Mortgagor general partner said the prior project manager had been with the firm 17 years and they trusted his performance. The files for the five test cases showed no evidence of review by the Mortgagor or the management agent for compliance with HUD certification and recertification requirements. Accordingly, the cost required to recalculate subsidies should not be charged as a project operating expense.

In deciding which cases to recalculate and for what periods, the Mortgagor should consider:

- Tenants whose subsidies decreased at the latest recertifications,
- VOEs obtained by the new manager which show more income or different employers than shown in prior computations, and
- Other relevant information developed by the new manager.

AUDITEE COMMENTS

The Mortgagor General Partner stated that the problem went unnoticed through several audits over the years. He stated he would continue to cooperate in every way to bring the matter to a close, and welcomed recommendations to ensure it does not happen again. He said he would take whatever corrective action we propose.

OIG EVALUATION OF AUDITEE COMMENTS

The General Partner's comments were responsive to the finding.

RECOMMENDATIONS

We recommend that you require the Mortgagor General Partner to:

- 1A. Contract, at non-project expense, with an independent third party, such as an independent accountant, to reverify tenant income and recalculate Section 8 subsidy where prior calculations appear questionable or lack proper documentation.
- 1B. Reimburse HUD, from non-project funds, for all excessive Section 8 subsidies identified by our recalculations and the recalculations performed in recommendation 1A.
- IC. Establish and implement controls and procedures to assure that, in the future, site personnel are regularly monitored for compliance with requirements for certifying and recertifying tenants and calculating Section 8 subsidy.

Finding 2 - Deferred Maintenance Needs to be Addressed

The Mortgagor needs to address deterioration caused by deferred maintenance. Repairs are needed to provide tenants the quality housing intended by the Section 8 Program and to protect HUD’s interest in the insured mortgage.

The Regulatory Agreement between the Mortgagor and HUD requires the owner to maintain the project in good repair and condition, and precludes the owner from taking surplus cash if he has not complied with notices of improper maintenance of the project (Sections 8 and 10).

The latest HUD inspection report dated December 13, 1996, advised the Mortgagor General Partner that the project rated below average in overall physical condition and maintenance policies and practices. We did a limited inspection of the project in November 1997 to determine the project’s general condition and if the Mortgagor had completed repairs required by the HUD inspection. We looked at project grounds, building exteriors, and 18 units also inspected by the HUD inspector. We noted the following status of a portion of the work required by HUD:

<u>Repair Category</u>	<u>Work Completed</u>	<u>Work Partially Done</u>	<u>No Work Done</u>
Repair/replace siding and trim			X
Repair concrete sidewalk			X
Repair/replace doors, windows, screens			X
Lawns and planting		X	
Exterior lighting	X		
Floors and carpet		X	
Cabinets, doors, closets, hardware		X	
Repair/replace refrigerator door gaskets		X	
Repair/replace whole house fans		X	
Replace electric switch and outlet covers	X		
Repair/replace leaking faucets	X		

In addition, we observed that:

- The exterior siding and trim not repaired or replaced showed signs of deterioration, especially at the bottom edges near the foundation. Gaps at the bottom edge can allow moisture between the walls, which could cause more serious structural damage.
- Playgrounds and playground equipment needed attention. The grounds were not maintained and the swing sets did not have swings attached.
- Floor tile replaced did not always match existing tile, which adversely impacted the cosmetic appeal of the units.

The project has been generating operating funds and the Mortgagor needs to use them to fix accumulating deferred maintenance. Between 1992 and 1996 the project generated over \$200,000 in surplus cash, most of which was taken by the owner in distributions. The Mortgagor needs to complete all deferred maintenance before being allowed to take future distributions.

AUDITEE COMMENTS

The Mortgagor General Partner stated that he hired a contractor in April 1997 to complete the repairs required by the HUD inspection, and the contractor is still working. He said no funds were distributed to partners in 1997. He said since our inspection in November 1997, almost all work has been completed on apartment interiors, but weather slowed the progress of work on exterior repairs. He said he was continuing to repair and maintain the apartments and grounds with operating funds as he has done in the past, but will take whatever corrective action we propose.

OIG EVALUATION OF AUDITEE COMMENTS

The General Partner's comments were responsive to the finding.

RECOMMENDATIONS

We recommend that you require the Mortgagor General Partner to:

- 2A. Provide you a summary of all deferred maintenance needed and a plan and timetable for timely completing the maintenance.
- 2B. Continue to refrain from taking distributions of surplus cash until all deferred maintenance is completed.

AUDITEE COMMENTS

DISTRIBUTION

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Assistant to the Secretary for Labor Relations (Acting), SL (Room 7118)
The Honorable Fred Thompson, Chairman, Committee on Governmental Affairs,
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The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs,
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Mr. Pete Sessions, Government Reform and Oversight Committee, Congress of the
United States, House of Representatives, Washington, DC 20515-4305
Ms. Cindy Sprunger, Subcommittee on General Oversight and Investigations,
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