December 9, 1998

Audit Memorandum
No. 99-NY-214-1801

MEMORANDUM FOR: Deborah VanAmerongen, Director, New York Multifamily HUB, 2AH

FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: Affordable Housing, LLC
d/b/a Aries Management
New York, New York

We conducted a review of Affordable Housing, LLC d/b/a Aries Management (herein called the Agent) pertaining to its management of Columbus Manor, Project No. 012-11067 and Westwood House, Project No. 012-11069. The Agent is also the Managing General Partner of the ownership entities of both projects.

We limited our review to determining whether the Agent used project funds in compliance with HUD regulations and requirements, and whether the Agent made necessary repairs to the projects, as mandated by HUD. During our review we: (1) reviewed regulations, directives, and records of the U. S. Department of Housing and Urban Development (HUD); (2) interviewed staff of HUD's New York State Office (NYSO) and the Agent; (3) examined the Agent's policies, procedures and records; (4) judgmentally tested financial transactions; (5) inspected both projects; and (6) assessed management controls relevant to our audit objectives. We noted that the independent audits for both projects covering the years ended December 31, 1996 and 1997, contained no findings.

We conducted our review in accordance with generally accepted government auditing standards. The review covered the period from January 1, 1996 through June 30, 1998, and was performed during the months of July and August, 1998.

SUMMARY

Our review disclosed that the projects were in need of substantial repairs when the Agent took over management of the projects in 1996. However, the Agent was slow in taking corrective actions in response to HUD's physical inspections conducted in April 1997, which rated both projects "below average". On April 1, 1998, after two follow-up visits by representatives of the HUD NYSO, the Vice President of the Managing General Partner was notified that the projects were not maintained in good repair and condition which is a violation of the Regulatory Agreement (e.g roofs, balconies, elevators,

exterior walls and foundations, etc. were found to be deficient). The NYSO directed the Managing General Partner to terminate its agreement with the Agent and to provide new management acceptable to HUD. After an April 20, 1998 meeting with HUD, the Agent was granted temporary permission to manage the projects contingent on compliance with numerous conditions, including the submission to HUD of a revised Management Improvement and Operating (MIO) Plan and the satisfactory completion of roof and elevator repairs.

A revised MIO Plan was approved by HUD in July 1998. We noted that the Agent is proceeding to make the required repairs, which will be funded 50 percent by replacement reserves (until depleted) and 50 percent by owner advances. At the time of our review, the roof and elevator repairs were progressing in accordance with the revised MIO Plan, and a bid package had been prepared for the procurement of the required foundation and balcony repair work. We also noted that apartment unit repairs were ongoing, and that the projects' building superintendents had established a positive rapport with the tenants.

Regarding the financial management of the projects, our review disclosed that the Agent charged both HUD-insured projects for the prorated salaries of its tenant certification clerks, contrary to NYSO policy. As a result, $28,065.97 ($17,423.25 for Columbus Manor, and $10,642.72 for Westwood House) are ineligible project costs. When we discussed this deficiency with the Vice President of the Managing General Partner, he immediately instructed his bookkeeper to repay the amounts in question to the projects. Details are provided in the Results of Review section of this memorandum.

We are recommending that your office verify that Columbus Manor and Westwood House were appropriately reimbursed for the excessive management costs incurred. Since the salaries for the tenant certification clerks were allocated to two other HUD-insured projects managed by the Agent (Townhouse West and Highbridge House), we are also recommending that the Agent submit evidence to HUD showing that all excessive charges to these projects have been reimbursed.

Our review also disclosed an issue that requires further study and evaluation by your office. The general ledger for Columbus Manor shows that a total of $198,571 is owed to the project by former partners. We believe that a legal determination should be made as to whether the current owners are liable to the project for theses amounts or whether the receivables should be discharged and removed from the project’s books and records.

BACKGROUND

The projects were built in the early 1970's, and are insured by HUD under Section 207, pursuant to Section 223(f) of the National Housing Act, as amended. The mortgages are held by the New York City Housing Development Corporation, and are subsidized through interest reduction payments under HUD's Section 236 Program.

The Mortgagors, Columbus Manor, Inc. and Westwood House, Inc., are housing companies organized under Article II of the Private Housing Finance Law of New York State. The Jonathan Company, a New York State limited partnership, is the owner of the beneficial interests in both projects; and Affordable Housing, LLC d/b/a Aries Management, is the current Managing General Partner.

Affordable Housing, LLC d/b/a Aries Management purchased the managing general partnership interests of Citi Equity Group, Inc. in 1995, by bidding on the partnership interests at a court ordered Chapter 7 bankruptcy sale involving Citi Equity Group's assets. HUD did not approve a Modified Transfer of Physical Assets (TPA) prior to the bankruptcy sale; and as of the date of this review, the TPA had not been approved. In 1996, Aries Management took over management of both projects and is still operating without a HUD approved management certification.

Columbus Manor is a 31 story high-rise development with 203 units, and Westwood House is comprised of 124 units in eight stories. Both projects are located on 93rd Street between Columbus Avenue and Central Park West in New York City. The Agent's office is located at the Columbus Manor project.

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Within 60 days, please furnish this office, for each recommendation cited in this memorandum 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 not considered necessary. Also, please furnish us copies of any correspondence or directives issued related to this audit.

If you have any questions, please contact me or Mark B. Klein, Assistant District Inspector General for Audit, at (212) 264-8000, extension 3976.

Attachment:
A - Distribution

RESULTS OF REVIEW

EXCESSIVE MANAGEMENT COSTS WERE CHARGED TO THE HUD-INSURED PROJECTS

Our review disclosed that the Agent received improper reimbursements from the HUD-insured projects on a prorated basis for the salaries of its tenant certification clerks. This occurred because the Managing General Partner was not aware that the certification clerks' salaries were considered costs to be included in the maximum management fee allowed by the NYSO. As a result, Columbus Manor and Westwood House were charged a total of $28,065.97 ($17,423.25 and $10,642.72, respectively) in excessive management costs.

Criteria

In 1989, the HUD NYSO determined that the maximum allowable amount that management agents may charge for management fees in high cost areas, such as New York City, was $59 per unit per month (PUPM) plus an additional $3 PUPM for computer-related services. The policy stated that these maximums included all costs that are managerial in nature, including management office staff, office rent and overhead costs. In 1992, the NYSO elaborated on what types of costs should be treated as managerial, and therefore, not to be paid with project funds. Among the items listed were costs for recertification clerks and tenant assistance clerks.

Noncompliance With NYSO Policy

Our review of payments made to the Agent from project funds disclosed that Columbus Manor and Westwood House were charged for the salaries of two certification clerks as well as the maximum $62 PUPM management fee. We determined that from January 1, 1997 through June 30, 1998, a total of $17,423.25, was charged to Columbus Manor and $10,642.72 to Westwood House for the excessive management costs.

The clerks' salaries were prorated and charged to five projects managed by the Agent: the two projects included in our review, two additional HUD-insured projects (Townhouse West-Project No. 012-11070, and Highbridge House-Project No. 012-11027), and one non-Federal Mitchell-Lama project. Since the clerks' salaries should not have been charged to the four HUD-insured projects, the prorated amounts of those clerks' salaries that were charged to those projects are considered ineligible project costs. The Vice President of the Managing General Partner was not aware of the NYSO policy prohibiting the charging of costs for tenant certification clerks.

Mortgagor Agrees To Make Repayments

When we informed the Vice President of the Managing General Partner that the Agent was not entitled to receive reimbursement for the clerks' salaries, he immediately directed the bookkeeper to repay each of the projects with the Agent's funds. While some reimbursement documentation was provided to us before we left the audit site, complete and appropriate documentation was not provided for all four projects. The Vice President agreed to provide all documentation evidencing the reimbursements to the NYSO.

RECOMMENDATIONS

We recommend that the Agent be instructed to:

1A. Comply with NYSO policies regarding allowable management costs.

1B. Provide you with documentation showing that Columbus Manor and Westwood House have been repaid a total of $28,065.97 ($17,423.25 and $10,642.72, respectively); and that the two other HUD-insured projects managed by the Agent, Townhouse West and Highbridge House, were also reimbursed for the excessive management costs incurred during our audit period.

MANAGEMENT CONTROLS

In planning and performing our audit, we considered the Agent's management controls, in order to determine our audit procedures and not to provide assurance on internal controls.

Management controls include the plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports:

We determined that administrative and accounting controls in the following areas were relevant to our audit objectives:

- Maintenance
- Financial Compliance
- General Management Practices

We assessed all relevant controls areas identified above.

A significant weakness exists if internal controls do not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports. Based on our review, we believe that a weaknesses exists in the Agent's compliance with the NYSO policy regarding management fees and costs (See Results of Review).

ISSUE REQUIRING FURTHER STUDY

During our review we also noted that the general ledger for Columbus Manor included three receivable accounts from former partners totaling $198,571 as well as offsetting allowances for doubtful accounts. One account of $155,000 was recorded as "Advances Receivable" while the other two accounts were shown as "Due from Partners" and totaled $43,571.

The project's independent public accountant was able to locate workingpapers that identified that the accounts were recorded prior to 1993, and indicated that the advances may have been made to former partners, whose partnership interests were purchased in 1986. The current Managing General Partner indicated that he intends to remove the accounts from the books in 1998. We believe that a legal determination may be necessary to determine if the current partners are liable to the project for these amounts or whether their purchase of the general partnership interests at the bankruptcy sale discharged the old receivables. If these receivables are discharged, then they should be removed from the project's books.

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