audit report
OFFICE OF INSPECTOR GENERAL

Issue Date
June 28, 1996
Audit Case Number
96-NY-214-1003

TO: Gerard W. Sheridan, Director, Office of Housing
New York Office

FROM: William H. Rooney, Assistant District Inspector General for Audit,
New York/New Jersey

SUBJECT: New England Management Co., Inc.
Multifamily Management Agent
Brooklyn, New York

We conducted an examination of the books and records of New England Management Co., Inc., (hereafter referred to as the Agent) for the period January 1, 1994 through June 30, 1995. During our audit period, the Agent managed 19 U.S. Department of Housing and Urban Development (HUD) insured and/or Section 8 assisted projects located throughout New York City. The purpose of the audit was to determine whether the Agent complied with the terms and conditions of the Regulatory Agreements and other applicable HUD regulations.

Our review disclosed that the Agent generally complied with HUD regulations; however, the Agent did not always document that project funds were used in the most economical manner. Specifically, the Agent: (1) made distributions at Owners' requests and repaid a loan when surplus cash was not available; 2) could not show that it was to the projects' advantage to use an identity-of-interest (IOI) maintenance company to perform general repairs and janitorial work; and (3) needs to strengthen its controls over the maintenance of financial records.

Within 60 days, please give us, for each recommendation made in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and 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.

Should your staff have any questions, please have them contact William H. Rooney, Assistant District Inspector General for Audit, at (212) 264-8000, Ext. 3978.

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Executive Summary

We conducted an audit of New England Management Co., Inc. (the Agent), who during our audit period managed 19 HUD-insured and/or Section 8 assisted projects located throughout New York City. The objectives of the audit was to determine whether the Agent complied with the terms and conditions of the Regulatory Agreements and other applicable HUD regulations.

We concluded that the Agent generally complied with HUD regulations; however, the Agent did not always document that project funds were used in the most economical manner. The Agent did not: (1) comply with the Regulatory Agreements and HUD requirements when making distributions and repaying loans to Owners; (2) comply with the Management Certifications when contracting for repair work with an identity- of-interest (IOI) maintenance company; and (3) adequately maintain its books and records in accordance with Generally Accepted Accounting Principles (GAAP).

The specifics concerning the above matters are discussed below.

Agent made improper distributions at Owners' requests

Our review revealed that between 1991 and 1995, the Agent made payments of $266,957 to Ownership entities and repaid an outstanding loan of $20,000 to an Owner when sufficient surplus cash was not available. Consequently, a total of $286,957 which could have been used to pay necessary operating expenses was withdrawn from project accounts; therefore, the Owners were not in compliance with the Regulatory Agreements. We attribute this deficiency to the Agent's adherence to Owners' requests to have funds made available to them in their partnership accounts, which is contrary to HUD requirements.

Agent did not support reasonableness of IOI maintenance costs

The review also revealed that contrary to its own contracting procedures and Management Certifications, the Agent did not solicit competitive bids or maintain adequate documentation to support that it paid the lowest rates available when hiring Old Towne Maintenance Company, an IOI firm to perform general repair/maintenance work at HUD related projects. Additionally, the Agent paid Old Towne for repairs of vacant units at one project which was not performed, and for duplicate/unsupported repair bills at the same project. We attribute these deficiencies to the Agent's belief that the costs charged by its IOI firm for general repair work were reasonable; therefore, bidding was not necessary. Since the Agent has not documented the reasonableness of Old Towne's costs, there is no assurance that payments were for necessary, reasonable, and proper project expenses, and that the mark-up costs charged by Old Towne (estimated to be over $595,000) were justified.

Financial records not maintained in accordance with GAAP

Furthermore, the review revealed that the Agent is not maintaining its financial records in accordance with GAAP and HUD requirements. Specifically, the review disclosed of the projects that: (1) cash balances reported in the general ledger of the projects do not reconcile with the cash balances reported on the bank statements; (2) the tenant security cash account and the tenants accounts receivables (TARs) are not reported in the general ledger of the projects even though subsidiary records are maintained; and (3) the tenant security payables and the TARs are not reconciled to subsidiary records. Additionally, the Agent's operating account which is used to pay for most of the operating costs of each HUD project is not adequately reconciled.

Consequently, HUD can not rely on the general ledger account balances maintained by the Agent, and there is no assurance that all the Agent's reimbursements from project funds are for expenses that are actually paid or paid timely. We attribute these deficiencies to the Agent's desire to maintain its financial records on a cash rather than accrual basis, and its desire to maintain total control over the disbursement and application of project expenditures.

Recommendations

We are recommending that the HUD New York Office make a determination regarding the amount of improper distributions that should be repaid to the projects by the Owners. Additionally, the Owners should be advised to discontinue the practice of requesting distributions when surplus cash does not exist.

We are also recommending that the Agent justify the use of the IOI contractor and the reasonableness of its costs. All costs for duplicate billings and for repair work which was not performed should be repaid to the project.

Furthermore, we are recommending that the Agent be required to maintain its financial records in accordance with GAAP and HUD requirements.

The results of the audit were discussed with representatives of the Agent during the course of the audit and at an exit conference held on May 21, 1996, attended by:

Agent Representatives

Douglas Rosenberg, President
Philip Rosenberg, Former President
Seymour Maslow, Vice President
Solomon J. Borg, Attorney

HUD - Office of Inspector General

William H. Rooney, Assistant District Inspector General for Audit
Mark B. Klein, Senior Auditor
Edgar Moore, Auditor

On June 11, 1996, the Agent submitted its written responses to the draft findings which are included as Appendix E to this report.

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Abbreviations

GAAP	Generally Accepted Accounting Principles
HUD	U.S. Deprtment of of Housing and Urban Development
IOI	Identity-of-Interest
OIG	Office of Inspector General
TAR	Tenant Accounts Receivable

Introduction

New England Management Co., Inc. (the Agent), managed 19 HUD related projects located in New York City.

Douglas Rosenberg is the President of the Agent, and the books and records are located at 80 Livingston Street, Brooklyn, New York.

The Agent has an identity-of-interest relationship with Old Towne Maintenance Company. Additionally, the former President of the Agent (father of the current President) is also a General Partner of some of the projects managed by the Agent.

Audit objectives

The objectives of our audit were to determine whether the Agent: (1) properly withdrew project funds when making owner distributions and loan repayments; (2) properly solicited bids or maintained other documentation supporting the reasonableness of costs paid to its IOI company; and (3) maintained adequate financial records.

Audit scope and methodology

We interviewed HUD New York Office officials as well as the Agent's officials and staff to evaluate the internal controls, and to obtain an understanding of the procedures required.

We reviewed cash receipt and disbursement transactions primarily related to four of the projects managed by the Agent. However, in certain instances we expanded the scope to include other projects. We also reviewed several months of transactions made from the Agent's centralized operating account as well as records related to the IOI firm's billings and payments to subcontractors to determine the IOI firm's mark-up on repair costs.

We examined the financial statements and reports submitted to HUD. We also reviewed randomly selected tenant records, and conducted inspections at four projects to determine the condition of the projects and to ensure that the repair work procured by the Agent was actually performed.

Audit period

Our audit covered the period from January 1, 1994 through June 30, 1995, and where appropriate was extended to include other periods. The audit field work was conducted between September 1995 and January 1996.

The audit was conducted in accordance with generally accepted government auditing standards.

A copy of this report has been provided to the Auditee.

Distributions and Loan Repayments Were Made When Surplus Cash Was Not Available

Between 1991 and 1995, New England Management (the Agent) made payments of $266,957 to Ownership entities and repaid an outstanding loan of $20,000 to an Owner when sufficient surplus cash was not available. Consequently, a total of $286,957 which could have been used to pay necessary operating expenses was withdrawn from project accounts, and the owners were not in compliance with the Regulatory Agreements. According to the Agent's President the payments were made because the Owners requested that the cash be available to them in their partnership accounts. The Agent believes that such payments do not constitute distributions until the funds are taken out of the partnership accounts by the individual Owners. We disagree with the Agent's interpretation of the term distributions. Moreover, we are recommending that the Owners be advised to repay to the projects any unallowable distributions and to discontinue the requests for improper distributions.

Criteria

The HUD Regulatory Agreements provide that distributions are authorized to be paid only from project surplus cash at the end of the fiscal year or semiannual period. Also, the Regulatory Agreements prohibit Owners or Agents from using project revenue to engage in any other business or activity not related and essential to the operation of the project. Simply stated the projects should not be in the business of lending project funds to individuals or other business enterprises. The term distributions is defined in the Regulatory Agreements as the withdrawal or taking of cash or any assets of the project, including the segregation of cash or other assets for subsequent withdrawal..., and excluding payment for reasonable expenses incident to the operation and maintenance of the project.

Additionally, Paragraph 2-11 of HUD Handbook 4370.2 Rev-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, provides that advances from Owners to pay for reasonable and necessary operating expenses may be repaid only from project surplus cash.

Management Agent made cash distributions to Owners and repaid a loan to Owners

Our review disclosed that the Agent managed 19 projects that had HUD-insured and/or Section 8 assisted projects; 17 of these projects had HUD insured mortgages. During our review of the projects' financial statements and the cash disbursement records maintained by the Agent, we found that six of the HUD insured projects that had current mortgages, the Agent made payments to Ownership entities and repaid an outstanding loan to Owners when surplus cash was not available.

Specifically, during the period from January 1, 1991 through July 31,1995, we found that the Agent made payments to Owners totalling $732,123 which exceeded surplus cash available at the end of each project fiscal year by $286,957. Of this total, $266,957 represent improper distributions and $20,000 represents an improper loan repayment (See Appendix B for details).

Management Agent comments

We discussed this issue with the Agent's officials at the conclusion of our audit. They explained that all payments to Owners from non-surplus cash were made at the Owners' requests, and were deposited to Owner's/partnership accounts.

The Agent officials stated that they were not distributing project funds to the individual Owners when they made the payments to the Ownership entities but merely transferring funds for the Owners' use. They do not believe that they should be held responsible for subsequent improper actions by the Owners. As explained in Appendix E the Agent said that they have the fiduciary and legal responsibility to follow directives of the Owners. Nevertheless, they subsequently advised us that they informed the Owners in 1995 that they would not make similar payments in the future.

OIG position

We do not concur with the Agent's interpretation of what constitutes a distribution, and believe that the $286,957 represent improper withdrawals of cash as defined in the Regulatory Agreements. While the Owner is ultimately responsible for the taking of the distributions, the Agent acting on behalf of the Owner, is required to comply with the applicable HUD regulations. We do not believe that an Agent's fiduciary responsibility includes violating regulations at the Owners' request.

The Agent's Vice-President also advised us that for three projects cited in this finding the recently received 1995 financial statements showed that the projects have surplus cash available to distribute. Accordingly, he believes that these Owners should not be required to repay any project funds distributed in earlier years.

Regarding the repayment of project funds, we agree with the Agent and have addressed this in Recommendation 1B.

Recommendations

We recommend that you :

1A. Inform the Agent that they are required to comply with the Regulatory Agreement as it relates to the term distributions.

1B. Require the project Owners to reimburse the projects if cash deficiencies exist at the end of fiscal year 1995. Specifically, deposit sufficient cash into the projects' operating accounts to eliminate the cash deficiencies.

1C. Instruct the project Owners to discontinue the practice of taking project funds and depositing them into partnership accounts when surplus cash is not available. If this practice does not cease, the Owners should be advised that appropriate sanctions will be imposed.

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New England Management Did Not Support the Reasonableness or Propriety of Payments Made to an Identity-of-Interest Maintenance Firm

Contrary to HUD requirements, New England Management (the Agent) did not solicit competitive bids or maintain adequate documentation to support that it paid the lowest rates available when hiring Old Towne Maintenance Company, an identity-of-interest (IOI) firm, to perform repair/maintenance work at HUD related projects. Additionally, the Agent paid Old Towne for repairs of vacant units at one project which was not performed, and for duplicate/unsupported repair bills at the same project. We attribute these deficiencies to the Agent's belief that the IOI firm costs were reasonable based on its knowledge of the local marketplace; and therefore, bidding was not necessary. The Agent further advised that a breakdown of internal controls during a period of high vacancies at the Medgar Evers project caused errors to be made in the payment process. Since the Agent has not documented the reasonableness of Old Towne's costs, there is no assurance that payments were for necessary, reasonable, and proper project expenses, and that the mark-up costs charged by Old Towne (estimated to be over $595,000) were justified. We are recommending that the Agent repay $38,591.27 for work not performed, and submit documentation to HUD so that determinations can be made regarding the eligibility of $11,903.04 in duplicate or unsupported repair bills and the reasonableness of Old Towne's mark-up costs.

Criteria

Paragraph 3(d) of the Management Certification for Projects with Identity-of-Interest or Independent Management Agents provides that the Agent agrees to "Purchase goods or services from individuals or companies having an identity-of-interest with the Owner or the Management Agent only if the charges levied by those individuals or companies are not in excess of the costs that would be incurred in making arms-length purchases on the open market."

Additionally, Paragraph 4 of the Certification provides that the Agent agrees to:

(a) Assure that all project expenses are reasonable in amount and necessary to the operation of the project.

(b) Exert reasonable effort to maximize project income and to take advantage of.... money saving techniques.

(c) Obtain contracts, materials, supplies and services....on terms most advantageous to the project and at costs not in excess of amounts ordinarily paid for such contracts, materials, supplies and services in the area in which such services are rendered or supplies and materials furnished.

(d) Solicit verbal and written cost estimates as necessary ... and document the reasons for accepting other than the lowest bid. The Agent must maintain copies of the documentation and make the documentation available for inspection during normal business hours.

IOI relationship with Old Towne

As certified in the Management Agent Profile submitted to HUD, the Agent has an IOI relationship with Old Towne. The Agent hires Old Towne to perform routine and non-routine repairs at all the projects owned by the Agent's principals and the principals of Old Towne. The Agent also hires Old Towne to provide janitorial services at some of the projects which are located on scattered sites.

Agent believes Old Towne costs are reasonable

The Agent's Vice-President believes that the costs charged by Old Towne are reasonable based on general cost standards in the industry. He stated that since Old Towne hires nonunion maintenance employees and hires unlicensed and uninsured contractors to perform the actual repair work, he is confident that their costs are the lowest available. The Vice-President asserted in written statements to HUD, that Old Towne is used only if their bid is competitive with other vendors.

HUD New York Office asks for documentation

The HUD New York Office began to question these assertions because a number of properties managed by the Agent incurred high annual maintenance and operating costs but remained in poor physical condition. On January 12,1995, and again on March 13,1995, the HUD Office requested that the Agent submit detailed cost and service comparisons to support the reasonableness of Old Towne's charges. Satisfactory documentation was not submitted to HUD as requested.

NO DOCUMENTATION TO SUPPORT OLD TOWNE COSTS ARE NECESSARY/REASONABLE

Over $2.5 million paid to Old Towne

During the period January 1,1994 through June 30,1995, we noted that Old Towne was paid a total of $2,581,059 for repairs and maintenance services at 14 HUD-insured/Section 8 projects managed by the Agent (including $228,772 for salaries of janitors and porters). We selected three projects with a high amount of payments to Old Towne to determine whether costs were reasonable and properly procured (Medgar Evers, Gloria B. Harding, and Sunset Park NSA I). A total of 17 repair contracts (representing all the contracts with Old Towne) and 23 repair invoices involving $240,107 in payments to Old Towne were examined. We also examined $27,380 in janitorial salaries charged by Old Towne to four projects (Sunset Park NSA I, NSA II, Sixth Avenue Rehab II, and Sunset Park Housing Assoc.).

Our review disclosed the following:

Agent did not obtain bids from other contractors

(1) No written bids or cost estimates were solicited prior to selecting Old Towne to perform the repair work, and no verbal bids were documented in the Agent's records.

(2) The Agent did not adhere to its own contracting procedures which require:

(a) That any major work whose value exceeds $5,000 must have three written competitive bids.

(b) If there is an emergency, a record should be made of at least three verbal bids.

(c) If Old Towne is used, extra care must be taken. Their bids must be at least five percent less than any competing bids.

Since the Agent did not obtain any competing bids, there is no assurance that Old Towne's costs were five percent lower than other companies that provided comparable services.

No cost comparison data

(3) No cost comparisons or other data was evidenced showing that repair costs (e.g. painting, flooring, carpentry, plumbing, etc.) charged by Old Towne were reasonable and not in excess of costs that would be incurred in arms-length transactions.

(4) Although the Agent advised that janitors' salaries charged by Old Towne were allocated based on usage patterns at various scattered sites, no employee time distribution records were maintained to support the salary charges to specific projects. Moreover, there was no documentation supporting the reasonableness of Old Towne's mark-up costs for janitorial salaries.

Agent did not justify pass-through arrangement

(5) The Agent did not adequately justify why it was advantageous to the HUD projects to use its IOI firm as a middleman or "pass-through" between the actual contractors that performed the repair work and the HUD projects. Moreover, the Agent did not support that Old Towne provided any viable service or function other than those services that would normally be provided by an Agent in fulfilling its HUD required management duties.

Old Towne merely hires other contractors to perform the actual repair work that it bills to the various projects. Old Towne prepares the contractors' invoices by taking the contractors' handwritten bills and preparing a computer generated invoice almost identical to their own. After obtaining work order approvals from project/Agent staff, Old Towne simply marks up the contractors' repair bills between 10 and 50 percent, and prepares its own computerized bill to be submitted to the Agent's President for payment from project funds.

Old Towne also mark-ups their janitorial payroll significantly and bills this amount to the projects for cleaning services. Using a conservative average mark-up of 30 percent for repairs and janitorial services, we estimate that Old Towne passed through to the projects at least $595,629 without cost justification.

PAYMENT FOR WORK NOT PERFORMED AND DUPLICATE/UNSUPPORTED BILLINGS

(A) Repair work not performed

Old Towne was paid for work not performed

During our physical inspections of randomly selected units at the HUD-insured project, Medgar Evers, we found that major repair work billed by Old Towne for five vacant units was not performed. A total of $38,591.27 in project funds was disbursed on March 31, 1995 to pay for these repairs, yet our inspections in October 1995 revealed that the repair work billed for these units was not done (see Appendix C for details). The Agent paid Old Towne without independently verifying and documenting that the work was completed.

Agent attributes deficiency to high vacancies at Medgar Evers

The Agent's Vice-President advised us that the monies that were paid to Old Towne for the above repairs were reapplied to other jobs billed by Old Towne. However, our examination revealed that not until we performed our inspections did the Agent begin to reallocate these funds . The Agent's official further stated that the above monies were paid as advances on proposals submitted by Old Towne and not on actual work performed. He stated that because of the desire to turn over a high number of vacancies at Medgar Evers during a short period of time deviations from the normal payment controls occurred. We believe that advancing project funds prior to the start of work is an improper management practice since it gives the appearance of preferential treatment, and in effect provides the IOI firm with interest free loans at the project's expense.

(B) Payments for duplicate/unsupported billings

Old Towne was paid for duplicate billings

Our review of payments made by the Agent also revealed that once a contractor's invoice is paid, the Agent does not keep a listing by apartment of what repair work was done, billed, and paid for at that apartment. Consequently, there is no assurance that invoices billed for the same work will not be paid twice. In fact, we found that the Agent paid $11,903.04 to Old Towne for repairs that were either duplicated with other previous bills or added without adequate justification (e.g. approved change orders) at five different apartments at the project, Medgar Evers (see Appendix D for details).

For example, on December 16,1994, Old Towne was paid $2,598.00 under contract No.43 for the following repairs at Apartment No.6F-701 Gates Avenue: installing floor tiles throughout the apartment, installing new base cove, repairing four closet doors and plastering and painting the entire apartment. On March 3,1995, Old Towne was also paid $2,675.94 under invoice No. 26757 for almost the identical work described in contract No. 43; and on March 23,1995, Old Towne was paid an additional $617.46 under invoice No.20605B for painting and plastering the apartment which was already paid twice under the previous payments. Since the latter two payments totalling $3,293.40 are apparent duplicates with the first payment we are questioning these costs pending an eligibility determination by HUD.

Safeguards need to be established

While we found no evidence to indicate that the above payment deficiencies existed at other projects managed by the Agent, we believe that adequate safeguards must be established to ensure that duplicate/unsupported payments are not made and the potential for waste and abuse is not increased.

Management Agent comments

In its response to the draft findings, (Appendix E) the Agent reiterated that it has no need to solicit bids on every item of work since its personnel are extremely familiar with the costs in the New York marketplace. Regarding the janitorial salaries, the Agent stated that Old Towne's costs are less than the costs that would be incurred if the Agent hired janitors from the Local 32-b union. The Agent further advised that no project funds were lost as a result of the instances of duplicate bills/ work not performed disclosed by the audit since all work has since been performed or the costs are in the process of being refunded to the project.

OIG position

We believe that the Agent has not provided sufficient documentation to OIG or to the HUD Field Office to support the reasonableness of repair/janitor costs charged by Old Towne and to support its compliance with the Management Certification. As stated in the finding, HUD has repeatedly asked for this information and to date has not received it. With respect to the questionable/ineligible costs for duplicate bills and work not performed, documentation evidencing that repayments were made or work has been completed subsequent to the audit should be submitted to the HUD New York Office for a review and determination.

Recommendations

We recommend that the Agent be instructed to:

2A. Comply with its own contracting procedures and Management Agent Certifications when obtaining bids or other cost estimates for general repair/ maintenance work. The IOI firm should be hired only if they are the lowest bidder. All documents related to the solicitation and selection of any contractor should be maintained by the Agent.

2B. Submit documentation to HUD showing that Old Towne's charges for repairs and janitorial salaries are necessary and reasonable. In this regard, an assessment should be made of whether the services and functions provided by Old Towne are necessary, and whether their mark-up costs are reasonable and proper project expenses.

2C. Repay $38,591.27 in project funds for repair work not completed, or submit documentation showing that the repairs were satisfactorily completed.

2D. Cease the practice of advancing project funds to contractors including Old Towne for work that has not been completed.

2E. Submit documentation to HUD so that determinations can be made regarding the eligibility of $11,903.04 in duplicate or unsupported repair bills. Any amounts determined to be ineligible should be repaid to the project.

2F. Implement internal controls to prevent its IOI firm or any other vendor from being paid twice for work already done.

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The Agent Needs to Strengthen Its Controls Over the Maintenance of Financial Records

The Agent is not maintaining its financial records in accordance with HUD requirements. Specifically, the review disclosed that: (1) the cash balances reported in the general ledger of the projects do not reconcile with the cash balances reported on the bank statements; (2) the tenant security cash account and the tenants accounts receivables (TARs) are not reported in the general ledger of the projects even though subsidiary records are maintained; and (3) the tenant security payables and the TARs are not reconciled to subsidiary records. Additionally, the Agent's operating account which is used to pay for most of the operating costs of each HUD project is not adequately reconciled. Consequently, HUD can not rely on the general ledger account balances maintained by the Agent, and there is no assurance that all the Agent's reimbursements from project funds are for expenses that are actually paid or paid timely. We attribute these deficiencies to the Agent's desire to maintain its financial records on a cash rather than accrual basis, and its desire to maintain total control over the disbursement and application of project expenditures.

Criteria

The HUD Regulatory Agreement requires that books and accounts must be complete and accurate, and maintained in such form as to permit a speedy and effective audit. HUD Financial Operations and Accounting Procedures for Insured Multifamily Projects Handbook 4370.2 Rev-1 provides that :

- The general objectives of the HUD prescribed accounting system include reporting on all financial transactions using HUD guidelines and Generally Accepted Accounting Principles...(Paragraph 2-2)

- In order to ensure that books are complete and reporting is uniform, prescribed accounts must be maintained as outlined and described... in the HUD chart of accounts.(Paragraph 2-4)

- The books of original entry must be kept current at all times, and postings must be made at least monthly to ledger accounts.(Paragraph 2-3)

In addition, HUD Handbook 4370.1 REV-2, Reviewing Annual and Monthly Financial Reports provides that commingling of funds in an Agent's account is an acceptable practice only if approved in advance by HUD and if the Agent can identify the exact amount of funds that belong to a particular project at all times. This is a privilege and may be revoked at any time.

(1) <u>INACCURATE CASH BALANCES</u>

Large differences in cash balances

Our review of the Agent's financial records for four projects revealed that there were large differences between cash balances recorded in the general ledger of the projects and the cash balances reported in the project bank statements. For example, at June 30, 1995, the cash balance in the general ledger for Gloria B. Harding was $729,194.58, yet the balance in the bank for the same period was a shortage of $63,936.73. Agent officials explained that the cash balances in their books of original entry/general ledger have to be adjusted by adding and subtracting various general ledger accounts to the general ledger cash balance to arrive at a corrected book balance prior to conducting a bank reconciliation. However, we believe that there should not be such significant differences between cash balances reported on a bank statement and cash balances reported on a cash basis general ledger. Although it is normal to make some adjustments (eg. outstanding checks and bank charges etc.) in order to reconcile the book balance with the bank balance, the Agent's adjustments are time consuming and preclude a speedy and effective audit.

(2) <u>TENANT ACCOUNTS NOT REPORTED IN GENERAL LEDGER</u>

General Ledger incomplete

Our review of the Agent's financial records for the HUD related projects also disclosed that the Tenant Security Deposits and Tenant Account Receivables (TAR) are not recorded in the general ledger of the projects. Agent officials state that this has occurred because their books are kept on a cash basis; however, it would appear that if the records are being maintained on a cash basis then all cash accounts including tenant security deposits should be recorded. The failure to maintain complete financial records is contrary to Generally Accepted Accounting Principles, and impedes effective monitoring by HUD since all financial information is not readily available on a monthly basis.

(3) TENANT ACCOUNTS ARE NOT RECONCILED

Tenant accounts not reconciled

While the general ledger of the projects include Tenant Security Payable accounts they are not reconciled to the subsidiary records or the individual project security bank statements. For example, the tenant security payable account reported in the general ledger for the project, Sixth Avenue Rehab I showed a negative balance of $1,073 yet the bank statement showed a balance of $6,809. A tenant security cash account should be established in the general ledger (as noted above), and this account and the tenant security payable account should be adjusted to reflect the true tenant security balances so that the books will be complete and accurate.

The review also showed that the TAR subsidiary records can not be reconciled to the Independent Public Accountant's (IPA) records or the year-end financial statements. We attribute this to the fact that the Agent does not post the IPA write-offs of TARs. Agent officials state that they do not post tenant receivable write-offs unless ordered to by the courts because they believe such write-offs will harm them in any legal actions brought against tenants. However, we believe that the IPA write-offs should be posted to the subsidiary records so that an accurate and complete accounting of tenant balances is maintained.

(4) **OPERATING ACCOUNT NOT ADEQUATELY RECONCILED**

Operating account not reconciled

The Agent maintains a separate bank account in their name to pay project related expenses for the HUD projects. However, this operating account is not adequately reconciled. The Agent's procedure is to issue computer generated checks from their operating account to pay the project vendors for all HUD related projects. On a weekly basis, the Agent draws a project check to reimburse itself for the checks issued out of the operating account. The reimbursement checks from the various projects are deposited into this operating account.

Distribution of checks are sometimes delayed

Agent officials stated that they use this centralized operating account to ensure that all project expenses are paid on a timely basis. For example, if a project does not receive Section 8 funds from HUD on a timely basis, essential expenses can still be paid by the Agent through this operating account. However, they did state that sometimes they hold up the release of the operating account checks until they are certain that sufficient project funds are available for deposit.

Agent only reconciles totals

In an attempt to ensure that project expenses are being paid timely, we examined the Agent's bank reconciliations for its operating account to determine which checks were outstanding. We found that while numerous checks are issued monthly for all HUD projects (ranging from 200 to over 600 checks a month), from the projects the Agent only reconciles the total dollars received from the projects to the total dollars of checks issued from the operating account. The resulting balance, which should represent outstanding checks, is not reconciled to the bank balance. Because of the huge volume of checks issued monthly from this account, it is difficult to readily identify which checks are outstanding at the end of a given month and the projects to which these checks pertain to. Consequently, the Agent can not provide assurance that project reimbursements received and deposited into the operating account were for actual project payments. Furthermore, there is no assurance that project reimbursements received in advance of payments are not being used for non-project related expenses to the benefit of the Agent.

We believe that project expenses should be paid from a separate project account not a centralized operating account where the reimbursements from all HUD projects are commingled. The centralized operating account and the process by which the Agent issues and releases checks from this account provides the Agent with the ability to obtain interest-free loans by using the float on the project funds received.

Management Agent comments

In its response to the draft finding, (Appendix E) the Agent advised that it is considering making changes to its various financial reporting systems in order to meet all the requirements of HUD and GAAP. The Agent stated that its centralized operating account has not been used in an improper manner, and has advantages for projects that have close to a negative cash balance. The Agent also advised that subsequent to our audit, it completed reconciliations for 1996 which are available for HUD review.

Recommendations

We recommend that the Agent :

3A. Be advised to comply with GAAP and HUD requirements when maintaining its general ledger.

3B. Ensure that general ledger cash balances of the projects accurately reflect bank cash balances of the HUD related projects.

3C. Establish tenant security cash accounts and tenants accounts receivables in the general ledger of the projects.

3D. Ensure that the tenant security cash accounts and the tenant security payable accounts for all HUD related projects are adequately reconciled.

3E. Ensure that the tenants accounts receivable subsidiary records reflect adjustments made by the IPA for write-offs.

3F. Submit to HUD or make available for review a current reconciliation of its operating account which would identify all outstanding checks and the fund balances for all HUD projects. These reconciliations should be performed on an ongoing basis. If a satisfactory reconciliation is not provided, the Agent should be advised to cease using the operating account to pay for project related expenses.

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Internal Controls

In planning and performing our audit, we evaluated the internal controls of the Agent to determine our auditing procedures and not to provide assurance on internal controls. Internal controls are the process by which an entity obtains reasonable assurance as to achievement of specific objectives. Internal controls consist of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

Relevant controls

We determined that the following internal control categories were relevant to our audit objectives:

- Financial Management
- Cash Receipts and Disbursements
- Procurement
- Maintenance and Repairs

We evaluated all of the control categories identified above by determining the risk exposure and assessing the control design and implementation.

Internal controls assessed

A significant weakness exists if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Assessment results

Based on our review, significant weaknesses were noted in the following control areas:

- Control over Financial Management (Finding 3).
- Control over Cash Receipts and Disbursements (Finding 1).
- Control over Procurement (Finding 2).

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Follow Up On Prior Audits

This is the initial Office of Inspector General (OIG) audit of New England Management Co., Inc.

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Schedule of Ineligible and Unsupported Costs

Finding Number	Ineligible (1)	Unsupported (2)
2	$38,591.27	$11,903.04
Total	$38,591.27	$11,903.04

(1) Ineligible Costs - Costs clearly not allowed by law, contract, HUD or local Agency policies and regulations.

(2) Unsupported Costs - Costs not clearly eligible or ineligible, but which warrant being contested (e.g. lack of satisfactory documentation to support the eligibility of the cost, etc.).

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NEW ENGLAND MANAGEMENT
BROOKLYN, NEW YORK
SUMMARY OF UNIT REPAIRS PAID FOR BUT NOT DONE

Bldg/Apt. No.	Contract No.	Check No.	Check Date	Olde Towne Invoice Amt.
715-3B	45	53546	03/31/95	7,809.59
735-6A	46	53546	03/31/95	8,328.02
735-2E	47	53546	03/31/95	7,798.87
735-3F	48	53546	03/31/95	8,828.26
745-2C	49	53546	03/31/95	5,826.53
				$ 38,591.27

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NEW ENGLAND MANAGEMENT
BROOKLYN, NEW YORK

SUMMARY OF DUPLICATE/UNSUPPORTED REPAIR BILLS

BLDG/APT No.	Contract No.	Invoice No.	Check No.	Check Date	Questioned Costs Amount	Reasons
701-3C	32	26958	D5097	03/29/95	$ 627.75	A
701-3C		26570 & 26951	D5097	03/29/95	384.18	B
701-1E	33	26569 26950	D5097	03/29/95	1,044.04	A
701-6A	35	26960	D5097	03/29/95	665.41	A
735-2B	36	26091	D5010	11/23/94	5,888.26	B
701-6F	43	26757 & 20605B	R53470 R53542	03/03/95 03/23/95	2,675.94 617.46	B B
				TOTAL	$11,903.04	

A - Unsupported charges
B - Duplicate charges

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