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October 16, 1995
Audit Case Number
96-FW-214-1001

TO: James E. Hicks
Director, Office of Housing, 6AH

FROM: D. Michael Beard
District Inspector General for Audit, 6AGA

SUBJECT: Credit Finance Corporation
Multifamily Management Agent
Dallas, Texas

In response to a request from the Dallas HUD Office, we performed an audit of the Credit Finance Corporation (CFC) for the period January 1, 1993, through December 31, 1994. The purpose of the audit was to determine if CFC properly accounted for cash receipts, made disbursements with project income that were reasonable and necessary to the operations and maintenance of the properties, and complied with the Regulatory Agreements and HUD requirements.

Generally, CFC maintained good records and followed sound management practices. However, the audit found that CFC: (1) made unauthorized distributions and did not remit residual receipts to mortgagees; (2) disbursed project funds for ineligible and unsupported costs; (3) diverted operating funds from one project to the owner and overcharged the project for bookkeeping services; (4) improperly implemented the automated Tenant Rental Assistance Certification System (TRACS); and (5) did not properly compute excess rental income for Section 236 projects.

Within 30 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 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 me or Frank Baca, Assistant District Inspector General for Audit, at (817) 885-5551.

Executive Summary

We have completed an audit of Credit Finance Corporation's (CFC) management of HUD-insured properties. The purpose of the audit was to determine if CFC properly accounted for cash receipts, made disbursements with project income that were reasonable and necessary to the operations and maintenance of the properties, and complied with the Regulatory Agreements and HUD requirements. The audit did not include any substantial physical inspections of the CFC-managed properties.

In general, CFC maintained good records and followed sound management practices. However, the audit found numerous instances of significant CFC violations of the Regulatory Agreements and HUD requirements; specifically CFC:

Made unauthorized distributions totaling $93,346 to the partners of three HUD-insured projects. Also, CFC did not remit $260,350 in residual receipts to the mortgagees of three projects.

Disbursed $78,439 in project funds for ineligible and unsupported bookkeeping/accounting fees, legal fees, prepaid management fees, professional dues, and project employee vehicle repairs.

Diverted $57,528 in operating funds from Park Creek Manor to the project owner, and overcharged the project $21,085 for bookkeeping services.

Improperly implemented an automated Tenant Rental Assistance Certification System (TRACS), resulting in $64,896 in unreasonable expenses.

Did not properly compute excess rental income on the Section 236 projects they manage.

The foregoing violations occurred because CFC ignored or did not have adequate controls to ensure adherence to HUD requirements. As a result, the financial and physical security of the HUD-insured properties, and thus the welfare and safety of the tenants, are at risk.

We are recommending that you require CFC to repay the projects for deposits owed and for improper and unreasonable withdrawals, disbursements, and diversions. Further, you should require CFC to implement controls to ensure future adherence to HUD requirements. Finally, should CFC refuse to repay monies owed the projects or to comply with HUD requirements, we recommend administrative sanctions and civil action be taken against the firm.

We sent a draft report to CFC on September 1, 1995, and requested an exit conference and written response by September 15th; however, CFC requested additional time. In a September 22, 1995 letter, we informed CFC that we needed a written response by September 28th and an exit conference no later than October 4th to ensure their comments would be included in the final report. The CFC president, citing health problems, requested an extension to November 1st, which we did not allow. However, we informed the CFC president that he could submit a response after report issuance, and HUD would give the response full consideration. Where appropriate, we have included in this report verbal comments made by CFC to OIG staff during the audit.

Abbreviations

AHMA	Assisted Housing Management Association
CFC	Credit Finance Corporation
HUD	U. S. Department of Housing and Urban Development
NAHMA	National Assisted Housing Management Association
OIG	Office of Inspector General
TRACS	Tenant Rental Assistance Certification System

Introduction

Credit Finance Corporation (CFC), a management agent headquartered in Dallas, Texas, manages 14 HUD-insured multifamily projects located in the Dallas/Fort Worth, Abilene, and San Antonio areas. The Dallas HUD Office services 11 of the 14 properties, the Fort Worth HUD Office services two and the San Antonio HUD Office services one. The 14 projects have 2,606 dwelling units. Also, for part of our audit period CFC managed another HUD-insured property serviced by the Dallas HUD Office (see Appendix D for a schedule of CFC managed properties). CFC also manages or owns other multifamily properties that are not HUD-insured.

The purpose of our examination was to determine if CFC properly accounted for cash receipts, made disbursements with project income that were reasonable and necessary to the operations and maintenance of the properties, and complied with the Regulatory Agreements and HUD requirements.

We began our audit at the request of the Dallas HUD Office. The examination included a review of the governing Regulations, HUD Handbooks, Regulatory Agreements, and Management Agreements. We interviewed HUD and CFC officials and staff. We also interviewed various current and former project employees, where appropriate.

Based on initial survey results, we concentrated our audit efforts on selected areas. Our audit procedures included, but were not limited to, a review of the following:

Cash disbursements/collections and payroll: We reviewed 1994 financial records for ten projects:

Abilene North	Oak Hollow
El Capitan	Park Creek Manor
Euless Square	Prairie Ridge
Garland Gardens	Rolling Meadows
Highland Hills Drive	Woodland City

CFC did not manage Park Creek Manor after February 1994. Therefore, we reviewed Park Creek Manor records from January 1993 through February 1994. Also, we incorporated into this report a previous OIG review of Highland Hills, which included costs from 1991-1993.

For cash disbursements we reviewed all relevant records supporting payments, including bank statements, canceled checks, invoices, purchase orders, general ledgers, and audited financial statements. For cash collections, we traced amounts collected from the projects' monthly rent rolls to bank deposits. For project payroll we performed testing of two periods at Park Creek Manor. We also reviewed employee timesheets supporting payroll charges at other projects.

Surplus cash, distributions and residual receipts: We reviewed computations for surplus cash, owner distributions, and residual receipts contained in the audited financial statements of Rolling Meadows, Euless Square, Oak Hollow, and Highland Hills Drive for 1988 through 1994. The review went back as far as 1988 because of errors in the reports. We also interviewed the CFC president and personnel from the independent auditor firm responsible for the financial statement audits.

Duties performed by Certified Occupancy Specialists (Specialists): The review included examining the Specialists' 1994 time sheets, and computing per unit per month payroll costs to implement the Tenant Rental Assistance Certification System (TRACS). To determine whether these costs were reasonable, we surveyed three independent contractors that provide similar services. We also interviewed Specialists, and current and former CFC employees and project employees regarding their duties and responsibilities. In addition, we performed limited reviews of selected Section 8 vouchers CFC submitted to HUD.

Follow-up on a previous OIG survey of Highland Hills Apartments: We updated and incorporated into this report the results of a previous survey of Highland Hills Apartments. The survey, performed in December 1993 and January 1994, covered the period January 1992 through November 1993, with testing expanded to include 1991 legal expenses.

Excess income reporting on Section 236 projects: We reviewed 1993 audited financial statements for findings related to Excess Income Reports. Audit steps also included a detailed analysis of the February 1995 Excess Income Report for Leigh Ann to determine if CFC correctly computed excess income. Based on these results, we reviewed 1994 Excess Income Reports for 8 of the 11 Section 236 projects (including Leigh Ann, Abilene North, El Capitan, Euless Square, Garland Gardens, Oak Hollow, Rolling Meadows, and Woodland City) to determine the accuracy of excess income computations. In addition, we reviewed the February 1995 Excess Income Reports for Abilene North and Oak Hollow due to excessive carry-forward balances.

We conducted the audit at CFC's office and the Dallas and

Fort Worth HUD Offices. CFC's office is at 1412 Main Street, Dallas, Texas. Our principal contact for the audit was Mr. Lawrence R. Burk, CFC's president.

The audit covered the period January 1, 1993, through December 31, 1994, although the period was extended when necessary. We performed field work at CFC from March to June 1995, and conducted the audit in accordance with generally accepted government auditing standards.

CFC Made Unauthorized Distributions and Did Not Remit Residual Receipts

CFC did not remit $260,350 in residual receipts to the mortgagees of three projects. Also, CFC made unauthorized distributions totaling $93,346 to the partners of three HUD-insured projects. By failing to remit residual receipts and making unauthorized distributions, CFC violated the Regulatory Agreements and HUD requirements. Residual receipts provide a source of funds for repairs or other HUD-approved purposes. Also, HUD limits owner distributions to ensure projects remain financially sound and well-maintained. This occurred because CFC disregarded HUD requirements, and did not verify the accuracy of information provided by the independent auditor. For two projects, unauthorized owner distributions resulted from CFC's failure to make required residual receipts deposits.

The Regulatory Agreements define:

surplus cash: as any cash remaining after: (1) the mortgage payment; (2) the required deposits to the reserve fund for replacements; (3) all payments for the obligations of the project; and (4) any remittances due HUD.

distributions: as the withdrawal of cash or any assets of the project, including the segregation of cash or assets for subsequent withdrawal, and excluding payment of reasonable operating expenses. The Regulatory Agreements limit distributions to: (The independent auditor is responsible for performing the annual financial statement audits of CFC's HUD project) 6 percent of the owners' initial equity investment in the project and (2) surplus cash.

residual receipts: as any cash remaining at the end of the fiscal period after deducting from surplus cash the amount of all allowable distributions.

The Regulatory Agreements require:

Written HUD approval before paying out any funds except reasonable operating expenses and necessary repairs.

Written HUD approval to make any distribution of assets or income of the project, except from surplus cash.

Owners to establish and maintain a residual receipts fund. Owners must deposit residual receipts with the mortgagee within 60 days after the end of the fiscal period. Also, disbursements from residual receipts require HUD approval.

Paragraph 2-10.B. of HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, states all distributions must be computed as of the end of the fiscal period. Also, if the owner elects to collect distributions semi-annually, then the owner must compute surplus cash as of the end of each semi-annual period. The Handbook further states these calculations shall be audited and the form HUD-93486, Computation of Surplus Cash, Distributions and Residual Receipts, included in the annual report.

Between 1988 and 1994, CFC did not remit $260,350 in residual receipts to the mortgagees of three projects. For Rolling Meadows, Highland Hills Drive, and Euless Square, CFC did not remit residual receipts of $74,741, $160,511, and $25,098, respectively. These amounts result from re-computations of surplus cash, distributions, and residual receipts on form HUD-93486 for the years 1988 through 1994. The review included recomputing these amounts because neither CFC nor its independent auditor took into account prior unauthorized distributions or residual receipts owed to HUD when making the computations.

In failing to remit required residual receipts, CFC disregarded Regulatory Agreement requirements in some cases. In these instances, CFC did not make the required deposits even though the independent auditor reported residual receipts due the mortgagee on the form HUD-93486. In other cases where residual receipts were due, the independent auditor computed surplus cash and available distribution amounts on the form HUD-93486, but left the residual receipts amount line blank. Nevertheless, CFC had responsibility for ensuring the accuracy of information the independent auditor provided.

CFC made unauthorized distributions totaling $93,346 to the partners of three projects. The partners of Rolling Meadows, Highland Hills Drive, and Oak Hollow received $67,771, $24,575, and $1,000, respectively, even though these projects did not have the necessary surplus cash. For Rolling Meadows and Highland Hills Drive, the unauthorized distributions occurred because CFC did not remit required residual receipts (i.e., if residual receipts had been paid as required, these amounts would not have been available for distribution). For Oak Hollow, CFC made the unauthorized distributions in clear violation of regulatory requirements.

The unauthorized distributions and unpaid residual receipts affect the projects' ability to make future emergency repairs. For Rolling Meadows and Highland Hills Drive, the funds distributed to the partners should still be on deposit with the respective mortgagee in the residual receipts accounts. The Regulatory Agreements require residual receipts because they act as a safety valve for making needed major repairs as the projects get older. At December 31, 1994, the residual receipts balances for Highland Hills Drive and Euless Square were only $13,281 and $1,070, respectively. Also, Rolling Meadows did not have residual receipts on deposit with the mortgagee at December 31, 1994.

CFC's president stated the independent auditor computes surplus cash and will respond to this item for CFC. CFC attributed part of the problem to the process. A Washington D.C. firm reviews audit reports for HUD, sends HUD the results of their review, and HUD sends a letter. CFC just received review results of 1993 audit reports. Funds may be gone because of the delays. However, CFC will see what it can do to get unauthorized distributions back from partners. As stated previously, CFC had responsibility for ensuring the accuracy of information the independent auditor provided. Also, in the case of Oak Hollow, CFC made unauthorized distributions when it clearly knew, or should have known, the project was in a non-surplus cash position.

Recommendations

We recommend the Fort Worth Office:

1A. Require CFC to implement controls to ensure the proper computation and payment of surplus cash, distributions, and residual receipts in the future.

1B. Require CFC to repay unauthorized distributions totaling $93,346 for Rolling Meadows, Highland Hills Drive, and Oak Hollow ($67,771, $24,575, and $1,000, respectively);

1C. Require CFC to make required residual receipt deposits totaling $260,350 for Rolling Meadows, Highland Hills Drive, and Euless Square ($74,741, $160,511, and $25,098, respectively); and

1D. Impose appropriate administrative sanctions and civil action against CFC for violating the Regulatory Agreements and HUD guidelines if CFC does not make the necessary repayments.

CFC Improperly Disbursed Project Funds

CFC improperly disbursed $78,439 in project funds, including $71,334 in ineligible and $7,105 in unsupported charges. This occurred because CFC did not follow the requirements of the Regulatory Agreements and other applicable HUD guidelines. The improper disbursements included payments for bookkeeping/accounting fees, legal fees, prepaid management fees, professional dues, and project employee vehicle repairs. These questionable disbursements involved all the HUD-insured projects that CFC managed, including two projects in default on their mortgage payments.

The Regulatory Agreements for multifamily projects state owners shall not, without the prior written approval of the Secretary, pay out any funds, other than from surplus cash, except for reasonable operating expenses and necessary repairs.

HUD Handbook 4350.1 REV-1, Insured Project Servicing Handbook, paragraph 10-17 states an owner may not use project funds to pay an attorney, agents, or representatives to develop a workout proposal for HUD to consider and/or to advocate that HUD approve the plan.

Chapter 4 of HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, provides the chart of accounts to be used for HUD-insured projects. The chart of accounts includes a series of accounts (the 7000 series) to record expenses applicable to the mortgagor entity as distinguished from expenses necessary and reasonable to the operation of the project.

In an October 31, 1989 memorandum to management agents, the Dallas HUD Office set the maximum allowable fee paid by HUD projects for bookkeeping fees. The memorandum, effective January 1, 1990, said the actual prorated cost for each project could not exceed $4 per unit per month. The memorandum also said any increase in the fee must be approved by HUD.

CFC charges $4 per unit per month on every project they manage for bookkeeping/accounting services, the maximum allowable by HUD for these services. HUD must approve any charges exceeding $4 per unit per month. However, CFC disbursed $9,361 from nine projects for excessive bookkeeping/accounting fees. The excessive fees represented unapproved charges in addition to the maximum amount that CFC already charged these projects. Invoices supporting the additional fees showed the services provided to be similar to the services included in CFC's $4 fee.

CFC paid $26,333 from five projects for ineligible legal fees. In addition, CFC could not provide adequate support for payments of $5,602 in legal fees for one project.

CFC charged Park Creek Manor $22,372 in 1993 for legal fees that violated the Regulatory Agreement and HUD Handbook guidelines. Over $15,000 went to a law firm for work representing the project owner in workout negotiations with HUD. In addition, CFC paid $7,000 to another firm for legal fees involving the owner.

CFC's president said the $7,000 payment involved a lawsuit brought by the owner of Park Creek Manor against the City of Dallas. However, a HUD attorney familiar with the case said the owner sued the City of Dallas in his name, not the project's, and Park Creek Manor could not benefit from the lawsuit. These improper payments for legal fees occurred when Park Creek Manor was in serious default on its mortgage payments. Park Creek Manor was $1.6 million in default by the end of 1994.

In addition, an OIG review of Highland Hills performed in December 1993 and January 1994 identified $3,961 in improperly disbursed legal fees. Generally, the legal fees paid involved partnership agreements for Highland Hills and three other projects: Euless Square, Woodland City and Highland Hills Drive. HUD guidelines do not consider these fees a project expense. The review also identified $5,602 in insupported legal fees.

The questionable legal expenses occurred in part because CFC's accounting system does not include the required general ledger accounts for expenses unrelated to property operations (7000 series accounts). Account number 7120 specifically provides for recording legal expenses related solely to the mortgagor entity.

CFC prepaid itself $33,440 in management and other fees from four projects. These prepaid fees, outstanding at December 31, 1994, were not necessary for the operation of the projects. CFC's Management Agreement with each project provides that management fees are only payable in the month following the actual service. Rolling Meadows had prepaid management and other fees to CFC over a 2-year period totaling $18,860. According to CFC's president, one $10,000 payment from Rolling Meadows to CFC was a mistake and would be repaid. The president said any prepaid fees would be corrected.

CFC paid $2,200 to the National Assisted Housing Management Association (NAHMA) for membership dues. CFC reimbursed itself for these dues from the 15 HUD-insured projects. The dues are not reasonable and necessary costs because each project already paid membership dues to join the Assisted Housing Management Association of North Texas (AHMA-NT). Dues paid by the projects to AHMA-NT include membership in NAHMA. Therefore, CFC should repay the 15 projects for the unnecessary membership dues. CFC's president said he believes the projects benefit from the NAHMA membership, but would respond to this issue based on his counsel's advice.

CFC paid $1,504 from two projects for repairs to employees' vehicles. The records did not support these payments as reasonable and necessary expenses. According to the management agent's president, CFC reimbursed the employees because they had taken actions to fight drug problems at the projects and as a result had sustained damage from gangs. CFC should provide additional support for these payments.

Recommendations

We recommend the Fort Worth Office:

2A. Require CFC to incorporate the 7000 series accounts into its accounting system to record expenses unrelated to project operations;

2B. Require CFC to repay the HUD projects $71,334 in ineligible disbursements (Appendix B);

2C. Require CFC to provide support or justification for $7,105 in questionable disbursements (Appendix B). If CFC cannot adequately support or justify the charges, require CFC to repay the HUD projects; and

2D. Impose appropriate administrative sanctions and civil action against CFC for violating the Regulatory Agreements and HUD Regulations should CFC not repay any improperly disbursed funds.

CFC Diverted Park Creek Manor Funds to Owner and Overcharged for Bookkeeping Services

CFC diverted $57,528 in operating funds from Park Creek Manor by returning a portion of its management fee to the owner. Also, CFC overcharged Park Creek Manor $21,085 for bookkeeping services. This occurred because CFC did not follow the terms of the Regulatory Agreement with HUD or its Management Agreement with the project. The diversions and overcharges caused unnecessary harm to Park Creek Manor, which CFC managed from June 1990 through February 1994. As of March 1, 1994, when CFC stopped managing the project, Park Creek Manor was in default by almost $1 million.

Park Creek Manor's Regulatory Agreement with HUD:

Limits the owner to using project funds only to pay reasonable expenses necessary to the operation and maintenance of the project (Section 3.b.(3)).

Requires the owner to obtain written approval before undertaking self-management, contracting for management services, or paying or incurring any obligation to pay fees for management services (Section 11.c.).

CFC's Management Agreement with the owner, signed June 1, 1990, sets a limit on bookkeeping fees. Paragraph 5.a. of the Management Agreement limits total bookkeeping fees, including data processing, to $3.50 per occupied unit.

CFC diverted part of its management fee from Park Creek Manor to the owner. CFC collected a monthly fee from Park Creek Manor equal to 7 percent of the project's gross income. Invoices supporting management fees show CFC collected the 7 percent fee, but then paid 2 percent of gross income back to the project owner each month. The estimated diversions to the owner total $57,528 for the period CFC managed the project. (The $57,528 consists of $16,084 in actual charges for the period January 1993 through February 1994, and $41,444 in estimated charges for the period June 1990 through December 1992).

A review of Park Creek Manor's records disclosed no evidence that the owner provided management services, nor did the owner obtain HUD approval to self-manage the project as required. CFC, in effect, provided management services to Park Creek Manor for a 5 percent fee. Park Creek Manor did not benefit from the diversions, nor did the diversions represent reasonable or necessary charges to the project. HUD officials agreed with our conclusion. CFC's President said this issue should be referred to Park Creek Manor's owner.

CFC overcharged Park Creek Manor $21,085 for bookkeeping services from January 1991 through February 1994. CFC did not adhere to its Management Agreement with the project, which limited charges for bookkeeping services to $3.50 per occupied unit. Instead, CFC charged the project up to $4 per unit per month, including vacant units. CFC should provide support that the overcharges were reasonable and necessary for the operation of Park Creek Manor, or return the overcharges to the project.

Park Creek Manor is in serious default on its HUD-held mortgage. The delinquency at January 1, 1995, totaled more than $1.6 million. The mortgage was current when CFC started managing the project on June 1, 1990. On January 1, 1991, Park Creek Manor defaulted on its mortgage payments and on July 9, 1992, the mortgagee assigned the mortgage to HUD. When CFC stopped managing Park Creek Manor on March 1, 1994, the project was delinquent by almost $1 million. For projects with assigned mortgages, HUD requires all remaining net cash to be remitted monthly to HUD, after the payment of reasonable and necessary project operating expenses. Therefore, the questionable charges CFC made to Park Creek Manor contributed to the project's financial troubles and adversely affected HUD.

Recommendations

We recommend the Fort Worth Office:

3A. Require CFC to repay Park Creek Manor $57,528 for ineligible management fees diverted to the owner;

3B. Require CFC to provide support for $21,085 in bookkeeping overcharges to Park Creek Manor, or repay the project; and

3C. Impose appropriate administrative sanctions and civil action against CFC for violating the Regulatory Agreement and HUD requirements if CFC does make the necessary repayments to Park Creek Manor.

Projects Incurred Unreasonable Expenses for TRACS Automation

CFC's method of operating the automated Tenant Rental Assistance Certification System (TRACS) caused 13 of its HUD-insured projects to incur $64,896 in unreasonable expenses. CFC implemented an automated TRACS in 1994 due to HUD requirements. However, the projects incurred unreasonable costs because CFC did not structure its system to meet HUD Regulations. CFC's system for TRACS: (1) caused questionable charges for computer equipment; (2) included inefficient manual computations and task duplication; and (3) did not provide adequate controls over staff time charged to the projects. CFC appears to use its non-conforming TRACS system largely as an excuse for charging property supervisors' salaries, which should be paid from management fees, to the HUD-insured projects. As a result, the projects paid unreasonable expenses for a system that an independent contractor can provide at significantly lower cost.

The Regulatory Agreements limit the use of project funds to reasonable operating expenses, necessary repairs, mortgage payments, and other purposes approved by HUD.

Title 24, Code of Federal Regulations, Part 208, requires owners and agents of subsidized multifamily projects to electronically transmit tenant certification, recertification, and subsidy billing data. The electronic transmission of data is to reduce the burden of manual forms, time consuming calculations subject to error, and the retroactive adjustments to subsidy billings due to the errors. The TRACS is HUD's computer system to collect this data.

The Regulations implementing TRACS appeared in the November 19, 1993 Federal Register. The summary and Final Rule accompanying the Regulations stated that owners and agents should immediately obtain information on the cost to automate, and determine the feasibility of either purchasing hardware and software, or contracting for the services.

The Regulations allow three ways for owners and management agents to implement the TRACS:

(1) Maintain computer hardware and software at each project site;
(2) Maintain computer hardware and software at a central

location; or
(3) Contract for the services.

On May 16, 1994, HUD's Southwest District Director of Housing established a range of $3.50 to $6 per unit per month as a reasonable fee for both bookkeeping/data processing and automation for TRACS. This effectively limited CFC to a $2 per unit per month fee for TRACS automation because CFC charged its projects $4 per unit per month for bookkeeping/data processing. The memorandum also stated that a survey identified the average cost of TRACS automation as $1.32 per unit per month.

Subsequently, HUD changed its definition of reasonableness of costs associated with TRACS automation. In a June 30, 1995 letter to owners and agents, the Southwest District Director of Multifamily Housing said the cost of the service cannot exceed the lessor of: (1) the prorated actual cost by management for providing these services or (2) a reasonable cost from an independent source. The letter also said both limits must be documented, and the documentation available for HUD's review.

CFC did not implement any of the three TRACS system structures allowed by the Regulations: (1) project-based; (2) central location; or (3) contract services. Instead, CFC's system consists of three Certified Occupancy Specialists (Specialists) who visit projects, automate tenant certification/recertification data, transmit data to HUD, and prepare monthly subsidy vouchers.

By not structuring its system as intended by HUD Regulations, CFC has implemented a TRACS system where: (1) computer equipment costs are questionable, and the equipment cannot be identified as belonging to specific projects; (2) on-site staff continue to make manual entries that are then duplicated by the Specialists' computer entries; and (3) there are inadequate controls over Specialists' time charged to the projects.

The Specialists use portable computers, printers, and software that CFC purchased for $10,464 and charged to the projects. CFC purchased this equipment to implement the automated TRACS system. Although HUD Regulations allow for this cost, CFC did not use one of three methods provided by the Regulations to carry out the TRACS. The method used by CFC resulted in unreasonable charges to the projects. CFC could have purchased the computer equipment itself, and then charged the projects reasonable fees to cover CFC's total cost of providing the TRACS services.

The projects paid for the computer equipment; therefore, the equipment should belong to the projects. However, CFC did not purchase the equipment for specific sites, but instead allocated the computer costs to 14 projects. As a result, the equipment cannot be identified as belonging to specific projects. Thus, some or all of the 14 projects risk losing monies for equipment they never received.

HUD intended that TRACS reduce burdensome manual computations prone to error. However, on-site staff at CFC-managed projects continue to make manual computations. The Specialists then enter data in portable computers using complete, executed certification/ recertification forms and work sheets the on-site staff manually prepared. The TRACS software automatically computes tenant income, family contributions, and assistance payments, making the on-site staff's manual computations unnecessary.

CFC could not demonstrate the reasonableness and necessity of the Specialists' salaries charged to the projects for TRACS-related work. This occurred because CFC did not have adequate controls for reporting time the Specialists charged to projects. The Specialists completed timesheets; however, the timesheets did not identify the types of work performed at any project (i.e., TRACS, fill-in for managers or assistant managers, etc.).

CFC had policies for on-site employees requiring that managers certify the accuracy of timesheets, supervisors approve overtime, and employees identify work performed during overtime. Yet, CFC did not apply these controls or document other controls as being in place for the Specialists. One Specialist said they obtained verbal supervisory approval to work overtime, but another Specialist said CFC had no rules on their overtime and they needed no supervisory approval. The latter appears more likely since CFC arbitrarily allocated the Specialists' overtime, holidays, vacations, and sick leave to the projects. Further, CFC was not consistent in charging normal business hours and time outside of normal business hours as regular pay or overtime. The following examples illustrate CFC's arbitrary and inconsistent salary charges for the Specialists:

Rolling Meadows. CFC charged 7 regular and 22 overtime hours for the 29 hours a Specialist's timesheet indicated for work performed at this project. However, the timesheet showed that 15 of these hours were during normal business hours.

Abilene North. CFC charged the project 20 regular hours; however, the Specialist's timesheet indicated 18 hours worked in 1 day, and 2-1/2 hours the next day.

Prairie Ridge. CFC charged the property 24 hours vacation and 16 hours holiday time for a Specialist. However, the Specialist had not charged any time to the project for the pay period preceding the vacation and holiday.

The Specialists appear to be CFC supervisors who should be paid from management fees. (The management fee must pay for salaries, fringe benefits, office expenses, fees and contract costs incurred in supervising project personnel, monitoring project operations, and analyzing and solving projoect problems (HUD Handbook 4381.5 REV-1, Management Documents, Agents and Fees; paragraph 2-14.A). In our opinion, CFC did not devise a TRACS system to comply with HUD requirements. Instead, it devised a system with additional duties for front-line supervisors. TRACS provided CFC with an excuse for charging its supervisory personnel to the projects.

In interviews the Specialists claimed to spend most of their time doing entries on the automated TRACS and preparing Section 8 vouchers. However, candid discussions could not be conducted with the Specialists because the CFC president insisted on being present at the interviews.

Despite CFC's contention that the Specialists perform front-line functions and are not supervisors, the review disclosed strong indications that the Specialists are primarily CFC supervisors:

A former employee who left CFC in July 1993 stated she performed supervisory duties while at CFC. These duties included approving purchase orders, auditing project books, mediating problems between tenants and project managers, and training on-site staff. She further stated that before she left, HUD began questioning supervisory expenses. At that time, the CFC vice president repeatedly told her and the other supervisors that they were Certified Occupancy Specialists, not supervisors.

A former Specialist also viewed herself as a supervisor, but was told by the CFC vice president to put Certified Occupancy Specialist down when preparing her time sheets. After leaving CFC in June 1994, the former Specialist worked for another management company where she performed similar supervisory duties. Working at her new job, the former Specialist said she was surprised that paychecks came from the agent account instead of project accounts until the employer told her the management fee was supposed to cover her salary.

The former manager for Highland Hills Apartments viewed the Specialists as supervisors even though they lacked the title. They ran the properties, acted in a supervisor's role, and seldom filled-in at the project or assisted in certifying tenants.

One current Specialist signs on-site employee vacation requests as the employee's supervisor. The Specialist also approved and excused an on-site manager's absence and recommended on-site employees for attending AHMA conferences and seminars.

The Specialists' overtime, unusual hours, and salaries are inconsistent with the claim that they spend most of their time on TRACS and vouchers. The three Specialists averaged 60, 53, and 45 hours per week, including late nights and weekends. This seems to reflect a situation where supervisors are handling problems at projects rather than clerical staff making data entries. One Specialist earns $14 per hour, another $13.50, while the junior Specialist earns $10.25 per hour. Overtime is paid at time and one-half.

The wide variance in Specialists' hours that CFC allocates to the projects is inconsistent with the claim that they work mostly on TRACS activities. For example, the number of Specialists' hours during 1994 averaged .74 hours per unit for Walnut Manor, 3.01 hours per unit for Highland Hills Drive, and 6.02 hours per unit for Prairie Ridge. These three projects are about the same size and are 100 percent assisted.

HUD-insured projects have incurred unreasonable costs because of CFC's method of automating TRACS. In 1994 CFC's projects paid over $98,000 for TRACS-related wages and benefits, with the average TRACS expense ranging between $1.25 and $9.64 per unit per month. The review estimates that 13 of 14 projects paid $54,432 above the $2 per unit per month amount that HUD considered reasonable. The excessive costs are especially important to defaulted projects like Highland Hills and Woodland City. The $54,432 only represents the cost of salaries and benefits - computer related costs are discussed above.

A review of information obtained from three independent contractors found that the projects could save almost $77,000 annually by contracting out the TRACS. These outside contractors provide the same or greater services than those CFC provides. Unlike CFC's cost, the prices associated with the outside contractors includes the cost of computers, software, and related supplies.

	Independent Contractors			
	A	B	C	CFC
Average Per Unit Per Month	$1.02	$1.05	$1.39	$4.66
Annual Cost	$21,846	$23,417	$29,480	$98,361

Recommendations

We recommend the Fort Worth Office:

4A. Require CFC to establish and maintain a Tenant Rental Assistance Certification System that complies with HUD regulations;

4B. Require CFC to provide documentation to show that its Tenant Rental Assistance Certification System costs do not exceed the lesser of: (1) the prorated actual cost by management for providing these services or (2) a reasonable cost from an independent source;

4C. Require CFC to reimburse the projects $54,432 for unreasonable payroll expenses due to its system of operating the TRACS (Appendix C);

4D. Require CFC to determine the amount of unreasonable expenses incurred by the projects in 1995 due to its system of operating the TRACS, and reimburse the projects the appropriate amounts;

4E. Require CFC to reimburse the projects $10,464 for unreasonable computer hardware and software costs (Appendix C); and

4F. Impose appropriate administrative sanctions and civil action against CFC for violating the Regulatory Agreements and HUD guidelines if CFC does not make the necessary repayments.

CFC Does Not Properly Compute Excess Income on Section 236 Projects

CFC does not properly compute excess rental income on the Section 236 projects they manage. As a result HUD may not receive amounts due from the projects. CFC's independent auditor reported the same problem existed during 1993. The independent auditor reports included findings that three projects underpaid excess income to HUD. The underpayments totaled over $33,000. This occurred because CFC did not follow instructions in preparing form HUD-93104, Monthly Report of Excess Income. CFC did not correctly compute total basic rents or adjustments to basic rents. For some projects, the incorrect computations resulted in significant carry-forward balances. Carry-forward balances offset any excess income due HUD in subsequent months. A recent OIG multi-district audit reported similar errors in the computation of excess income at other projects around the country. (Audit report number 95-SF-111-0001 issued December 21, 1994). The report said the errors led to inflated carry-forward balances that will continually offset any excess income due HUD.

Paragraph 2-14.A. of HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, defines excess rent on Section 236 projects as the amount by which the rent collected on a dwelling unit exceeds the approved basic rent for that unit. If the amount of rent collected is less than the approved basic rent, that balance is carried forward to the next month.

The Regulatory Agreements for Section 236 projects state owners shall remit excess rental income to HUD monthly. The Regulatory Agreements also say the remittance shall be accompanied by a report on a form approved by HUD.

HUD Handbook 4370.2 REV-1, paragraph 2-15.A. provides that form HUD-93104, Monthly Report of Excess Income, shall be used to calculate excess income. The Handbook also states that form HUD-93104A, Schedule for Calculating Excess Income, should be used to help with the completion of form HUD-93104. The figures from a correctly computed form HUD-93104A transfer directly to the form HUD-93104. Both HUD forms contain explicit instructions for their proper completion.

The instructions for form HUD-93104A require an individual listing for each unit of basic rents, collections, and adjustments to basic rents. An amount for basic rent should only be entered for units occupied one or more days in the month. Vacant and HUD-approved non-income producing units should be zero. Adjustments to basic rents only apply on units occupied a portion of the month. The amount of adjustment entered is the basic rent divided by 30 days multiplied by the number of days the unit is vacant.

CFC's excess income reports are incorrect because they do not follow the instructions for completing form HUD-93104 and form HUD-93104A. A review of reports for eight projects for 1994 and three projects for 1995 disclosed errors in all reports:

On form HUD-93104A, CFC enters only total figures instead of listing unit amounts as required. For basic rents, CFC uses the total basic rents for all units as listed on the HUD-approved Rental Schedule. The form HUD-93104A instructions require vacant and non-income producing units to be excluded from basic rents.

For its adjustments to basic rents, CFC obtained vacancy totals from monthly rent rolls. These vacancy totals included units vacant the entire month or part of the month. The form HUD-93104A instructions state that adjustments should be on a unit-by-unit basis, and only include units that were vacant part of the month.

The vacancy totals CFC obtained from the monthly rent rolls did not include correctly calculated adjustments for units occupied for part of the month. In addition, the monthly rent roll reports used by CFC do not contain move-in/move-out data needed to compute each month's adjustments.

The review did not include recomputing the correct excess rental income. However, HUD remains at risk of not receiving excess income due because of the incorrect computations.

The reports for two projects in the review, Abilene North and Oak Hollow, contained significant carry-forward balances as of February 1995. The balances totaled over $92,000 for Abilene North and over $352,000 for Oak Hollow. Carry-forward balances occur when a project does not collect rent equal to the basic rent each month. For these two projects, such a situation would have to exist for many years. More likely it is that CFC's continual errors in computations over a long period resulted in the overstated carry-forward balances. Carry-forward balances offset future excess rental income, and can therefore be significant.

For 1993 the independent auditor reported excess income findings on 5 of CFC's 11 Section 236 projects. The findings said CFC's errors in calculating excess rental income resulted in underpayment of over $33,000 to three HUD-insured projects. These three projects are still repaying HUD. The independent auditor also said the errors resulted in carry-forward balances being overstated by $28,941 for three of the projects.

Recommendations

We recommend the Fort Worth Office:

5A. Require CFC to follow the instructions for completing form HUD-93104, Monthly Report of Excess Income and form HUD-93104A, Schedule for Calculating Excess Income;

5B. Monitor CFC reports, on a test basis at least, to ensure excess income is being accurately reported; and

5C. Require CFC to restate the carry-forward balances for Abilene North and Oak Hollow to zero.

Internal Controls

In planning and performing our audit, we considered CFC's internal controls in order to determine our auditing procedures and not to provide assurance on the internal controls. Internal controls consist of 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 are obtained, maintained, and fairly disclosed in reports.

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

Accounting Controls: Cash receipts and disbursements
Administrative Controls: Regulatory Agreement Requirements and HUD Handbook Requirements

We assessed all of the relevant controls identified above.

It is a significant weakness 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. Based on our review, we believe the following items are significant weaknesses:

CFC lacks internal administrative controls to ensure project funds are disbursed in compliance with laws, regulations and policies (Findings 2, 3, and 4). As management agent, CFC has control over the payment decision process for all its projects.

CFC lacks administrative controls to ensure the proper computation and payment of surplus cash, distributions and residual receipts, and the proper computation of excess income on Section 236 projects (Findings 1 and 5).

Issues Needing Further Consideration

In addition to the findings, the audit identified issues needing further consideration. Although important, we did not think these issues warranted being reported as audit findings.

CFC maintains special escrow accounts at each of its 14 projects. The projects make monthly payments to these accounts from their regular operating accounts. CFC uses these funds to make additional project payroll payments that occur more than twice each month. These accounts are styled in the name of CFC and not the projects' names as required by HUD. In addition, CFC does not include the amounts in these accounts as part of the cash computations in Monthly Accounting Reports sent to HUD. CFC should restyle these accounts in the name of each project and include the amounts as part of any Monthly Accounting Reports requested by HUD.

Four projects had over $1 million in accrual balances for unpaid management fees to CFC at December 31, 1994:

Project	Unpaid Management Fee
Abilene North	$ 236,805

Garland Gardens	273,787
Leigh Ann	330,413
Park Manor	203,190
Total	$1,044,195

These accruals have increased for several years. These large liabilities could seriously affect the financial stability of the projects should CFC stop managing one of the projects or decide to collect all or a significant amount of the accruals. Also, five other projects had accrued management fees at December 31, 1994, amounting to $40,425 (Walnut Manor, Prairie Creek Manor, Prairie Ridge, Euless Square, and El Capitan). We recommend HUD work out an agreement with CFC to discontinue the practice of accruing unpaid management fees and resolve prior accruals.

Appendix A

Schedule of Questioned Costs

Recommendation Number	Ineligible(1)	Unsupported(2)	
1B	$ 93,346	$ -	
1C	-	260,350	
2B	71,334		
2C	-	7,105	
3A	57,528	-	
3B		21,085	
4C	54,432	-	54,432
4E	10,464	-	
TOTALS	$287,104	$288,540	-

(1) Costs clearly not allowed by law, contract, HUD, or local agency policies or regulations.

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

Appendix B

Schedule of Ineligible and Questioned Disbursements Supporting Finding 2

Date	Check No.	Project	Payee	Amount	Total
A. Ineligible Disbursements					
1. Payments for NAHMA Executive Council Dues					
02/17/94		All 15 Projects	CFC	$2,200.00	$ 2,200.00
2. Payments for Bookkeeping/Accounting Fees					
03/16/94	1099	Prairie Ridge	Ceridian	1,313.75	
03/16/94	1266	G. Gardens	Ceridian	38.97	
03/16/94	1160	El Capitan	Ceridian	85.70	
04/21/94	1192	R. Meadows	Ceridian	324.34	
04/25/94	1198	R. Meadows	Ceridian	348.09	
04/25/94	1227	El Capitan	Ceridian	183.74	
04/28/94	1202	R. Meadows	Ceridian	1,263.40	
04/28/94	1203	R. Meadows	Ceridian	495.34	
04/28/94	1229	El Capitan	Ceridian	1,206.38	
05/06/94	1228	R. Meadows	Ceridian	495.24	
12/22/94	2271	H. Hills Dr.	Bock & Bock	601.05	
12/22/94	1701	R. Meadows	Bock & Bock	601.05	
12/22/94	4	Other Projects	Bock & Bock	2,404.22	

				9,361.27	
3. Payments for Legal Fees					
03/12/91	1751	H. Hills	Strasburger	943.50	
01/13/93	1671	Pk. Ck. Manor	R. Albright	7,000.00	
01/27/93	2102	H. Hills	Strasburger	139.50	
04/29/93	2283	H. Hills	Strasburger	187.06	
06/18/93	1944	Pk. Ck. Manor	Coan & Lyons	516.00	
07/19/93	2001	Pk. Ck. Manor	Coan & Lyons	1,163.39	
08/30/93	2075	Pk. Ck. Manor	Coan & Lyons	4,682.90	
09/27/93	2448	H. Hills	Strasburger	451.83	

09/30/93	2127	Pk. Ck. Manor	Coan & Lyons	3,580.35
11/05/93	2202	Pk. Ck. Manor	Coan & Lyons	4,259.35
12/31/93	1984	Euless Square	H. Hills	778.39

Date	Check No.	Project	Payee	Amount
12/31/93	1098	H. Hills Dr.	H. Hills	778.39
12/31/93	2831	Woodland City	H. Hills	682.28
12/31/93	2276	Pk. Ck. Manor	Coan & Lyons	748.86
04/12/94	1091	Pk. Ck. Manor	Coan & Lyons	420.81

				26,332.61

4. Payments for Prepaid Management and Other Fees as of 12/31/94

El Capitan	CFC	4,200.00	
Oak Hollow	CFC	4,087.00	
Woodland City	CFC	6,293.00	
R. Meadows	CFC	8,860.00	
R. Meadows	CFC	10,000.00	34,440.00

Total Ineligible Disbursements $71,333.88

B. Questioned Disbursements

1. Payments for Repairs to Employees Vehicles

02/08/94	1115	El Capitan	B. Rodriquez	1,338.84	
03/11/94	1082	Woodland City	Auto Glass	165.00	1,503.84

2. Payments for Legal Fees

07/31/91	1440	H. Hills	Strasburger	388.50	
05/12/92	1811	H. Hills	Winstead	500.00	
09/23/92	1958	H. Hills	Strasburger	893.00	
12/31/92	2067	H. Hills	Johnson	1,320.25	
06/15/93	2333	H. Hills	Winstead	2,500.00	5,601.75

Total Questioned Disbursements 7,105.59

Total Ineligible and Questioned Disbursements	$78,439.47

Appendix C

Schedule of Ineligible Costs Supporting Finding 4

Unreasonable Expenses For Specialist's Salaries
(Based on 90% of the Specialists' salaries from April 1, 1994, through December 31, 1994. The 90% estimate is based on interviews with the Specialists. Also, the questioned amounts are net of a $2 per unit per month allowance)

Abilene North	$1,041
El Capitan	6,534
Euless Square	4,806
Garland Gardens	5,696
Highland Hills	3,803
Highland Hills Drive	2,565
Leigh Ann	1,267
Oak Hollow	144
Park Manor	4,170
Prairie Creek Manor	2,294
Prairie Ridge	6,876

Rolling Meadows	12,131
Woodland City	3,105

Total	$54,432

Unreasonable Expenses For Computer Equipment, Supplies and Software

El Capitan	$1,358
Highland Hills Drive	1,251
Rolling Meadows	1,250
All Projects (14 x $471.83)	6,605

6,605

Total	$10,464

Appendix D

Schedule of Projects Managed by Credit Finance Corporation

No.	Project Name	Project Number	Section of Act	Total Units	Sect 8 Units	HUD Held	Default
1	Abilene North Abilene, TX	113-44036	236	130	101	No	No
2	El Capitan Dallas, TX	112-44015	236	150	75	No	No
3	Euless Square	113-44029	236	150	52	No	No

	Euless, TX						
4	Garland Gardens Garland, TX	112-44119	236	216	85	No	No
5	Highland Hills Dallas, TX	112-44086	236	304	218	Yes	Yes
6	Highland Hills Drive Dallas, TX	112-35251 (d)(3)	221	100	100	Yes	No
7	Leigh Ann Dallas, TX	112-44041	236	256	153	No	No
8	Oak Hollow Dallas, TX	112-44049	236	160	107	No	No
9	Park Creek Manor Dallas, TX (1)	112-94008 (f)	223	321	0	Yes	Yes
10	Park Manor Irving, TX	112-35327 (d)(4)	221	210	82	No	No
11	Prairie Creek Manor Dallas, TX	112-44020	236	144	72	No	No
12	Prairie Ridge Grand Prairie, TX	112-35243 (d)(3)	221	100	100	No	No
13	Rolling Meadows Dallas, TX	112-44001	236	288	77	No	No
14	Walnut Manor San Antonio, TX	115-44169	236	98	38	No	No
15	Woodland City	112-44066	236	300	175	No	Yes

(1) CFC did not manage Park Creek Manor after February 1994.