



U.S. Department of Housing and Urban Development

Pacific/Hawaii

**Office of Inspector General for Audit
450 Golden Gate Avenue, P.O. Box 36003
San Francisco, California 94102-3448**

October 11, 1995

Audit-Related Memorandum
96-SF-214-1801

MEMORANDUM FOR: Michael Kulick, Acting Director Multifamily Housing Division,
9DH

FROM: Gary E. Albright, District Inspector General for Audit, 9AGA

SUBJECT: Limited Review of International Realty and Investments
Multifamily Management Agent
Los Angeles, California

INTRODUCTION

We performed a limited review of International Realty and Investment's (IRI) management activities as they related to the expenditure of Finley Square Cooperative, Inc.'s funds. Our objective was to determine whether IRI used Finley Square funds only for valid project expenses. We conducted the review because of information indicating that funds may have been used for other than reasonable and necessary project expenses.

SUMMARY

IRI records for Finley Square disclosed that IRI: (1) obtained project funds for itself by falsifying invoices to inflate a vendor's actual charges; (2) improperly used project funds to pay a project coordinator to prepare an evidence package to support allegations against a former management agent; and (3) had no support, or inadequate support, for some amounts paid to outside vendors and to itself. As a result, project funds were unnecessarily depleted and neither the owners of Finley Square nor HUD can be assured that the project's funds were spent for necessary expenses. We attribute the deficiencies to a disregard for HUD requirements.

We are recommending that IRI be required to repay the ineligible expenditures and any other expenditures that can not be shown as necessary and reasonable for Finley Square operations. In addition IRI's fitness to be a manager of HUD assisted properties should be evaluated and the firm terminated if appropriate.

BACKGROUND

Finley Square is an 18 unit apartment complex located in South Central Los Angeles, California. Finley Square had its \$347,900 mortgage loan insured by HUD in May 1973 under Section 236 of the National Housing Act. IRI has managed the project since October 1993.

OBJECTIVE AND METHODOLOGY

Our objective was to determine if IRI, as the management agent for Finley Square, spent the project's funds only for reasonable and necessary project expenses. To accomplish this objective we interviewed IRI officials, reviewed and evaluated project documents at IRI, and interviewed one vendor. We chose four months of Finley Square paid expenses for our detailed review. The months of December 1993, April and September 1994, and May 1995 were selected as representative of the entire period that the project was managed by IRI.

REVIEW RESULTS

Finding - IRI Used Project Funds for Ineligible and Unsupported Expenditures

IRI inflated certain maintenance costs and paid expenses that were not related to the operation of the project. In addition, IRI's records were generally not adequate to show that amounts paid to outside vendors and itself were necessary and reasonable.

In the Management Agent's Certification for Multifamily Housing Projects for Identity of Interest or Independent Management Agents (Management Certification), IRI agreed to ensure that all expenses were reasonable and necessary, and establish and maintain the project's accounts, books and records in accordance with HUD's administrative requirements, generally accepted accounting principles, and in a condition that would facilitate an audit.

Ineligible Expenses

Inflated Maintenance Expenses - IRI used its own funds to pay an outside vendor for plumbing work at the project, then made up false invoices to inflate the costs to the project. As a result IRI improperly diverted at least \$150 in project funds.

During our review we noted that two project checks totaling \$658 that had been made payable to a plumber had been endorsed over to IRI by the plumber. The payments were supported by seven separate invoices. We followed up with the plumber to determine why he had endorsed the two checks over to IRI. The plumber told us that the invoices IRI gave us were not his and that he did not endorse those checks. The plumber said that he had done the repairs shown on the invoices, but had billed for less. The plumber gave us his copies of the actual invoices he had given to IRI. When we compared the seven IRI invoices with those the plumber gave us we found that the IRI invoices ranged from \$5 to \$40 higher than the plumber's. IRI, through those seven invoices, overcharged Finley Square \$150. The IRI invoices totaled \$658 compared to the \$508 the vendor had actually charged.

At the exit conference, and in a written response, IRI's owner claimed that the plumber gave him a discount on all the charges and that was the reason for the difference in the invoices. In our opinion that is not a reasonable explanation. IRI's use of inflated and false invoices along with forged endorsements on the checks is a highly irregular way of

accounting for trade discounts. In any case such an explanation is not acceptable since in paragraph 4d of its management certification IRI agreed to pass on all discounts and rebates to the project.

Non Project Expenses

IRI used \$4,936 in Finley Square funds to pay for an evidence package that had nothing to do with the operation of the project. Of the total, \$4,766 was paid to a project coordinator that wanted to make a complaint against the former management agent for Finley Square, and another \$170 was paid to a vendor for information that went into the package. Those were not necessary and reasonable project expenses.

IRI said in its written response that the evidence package was necessary in order to address the issue of the replacement and reserves that had been depleted by the project. The invoice that the project coordinator sent to IRI for payment showed that she was billing for putting the evidence package together so that the Housing and Urban Development Office of Inspector General would review the former management agent. The invoice did not include any reference to the project's replacement and reserves. The evidence package did not in any way benefit Finley Square and its cost should not be borne by the project.

Unsupported Expenses

A significant amount of project funds disbursed by IRI during the months that we tested were either not supported, or insufficiently supported, as to reasonableness or necessity. Our four test months included 47 payments totaling \$56,675 that were made by IRI for Finley Square in 1993, 1994, and 1995. Eleven of the payments totaling \$9,675 (17%) had inadequate supporting documentation. Five of the 11 were to outside vendors and there were no invoices or other documentation supporting the payments. The remaining six payments were to IRI. Those payments were supported by seven invoices totaling \$8,503; however, none of the invoices reflected the date of the work, the time spent to do the work, or the amount and cost of materials used. Those are all essential items of information whenever an identity-of-interest exists between a management agent and the vendor that is doing the work.

In its written response IRI agreed to provide the missing support.

RECOMMENDATIONS

We recommend that you instruct IRI to:

- A. Reimburse the \$150 in inflated plumbing charges and any other inflated vendor charges to Finley Square;
- B. Reimburse \$4,936 to Finley Square for the amounts it improperly paid for non project expenses; and

- C. Provide support for all amounts paid to IRI for expenses of Finley Square since October 1, 1993. IRI should reimburse Finley Square for any payments that it can not support as being reasonable and necessary.

We further recommend that you:

- D. Evaluate the actions of IRI as they relate to its management of Finley Square, and determine whether that firm should be barred from managing HUD properties; and
- E. Advise Finley Square's Board with the results of this review of IRI's management activities.