



Issue Date December 5, 2007
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Audit Report Number 2008-NY-1002
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TO: Rosalinda Lamberty, Director, Multifamily Housing, 2CHM

FROM: *Edgar Moore*  
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: Richard A. Hutchens and Associates, Management Agent, Buffalo, New York,  
Used Project Funds for Ineligible and/or Unsupported Costs

## **HIGHLIGHTS**

### **What We Audited and Why**

In response to a request by the U.S. Department of Housing and Urban Development (HUD) Buffalo, New York, field office staff, who were concerned over questionable expenditures by an identity-of-interest company, we audited Richard A. Hutchens and Associates (agent) pertaining to its management of the financial operations of Cayuga Village (Project No. 014-35163) and Touraine Apartments (Project No. 014-35035).

The objectives of our audit were to determine whether the agent used project funds in accordance with the regulatory agreement and HUD requirements. Specifically, we wanted to determine whether the agent (1) provided adequate documentation to support the reasonableness of payments made to an identity-of-interest company, (2) made loans and withdrawals of residual receipts that were authorized, and (3) disbursed project funds for expenditures that were reasonable and necessary.

### **What We Found**

The agent did not solicit competitive bids or maintain adequate documentation to support that it paid the lowest rates available when hiring an identity-of-interest company to perform repair and maintenance work. We attribute this condition to the agent's failure to follow HUD regulations. As a result, the agent cannot ensure HUD that all transactions were at arms length and that the services

obtained were at the most reasonable and economical price. Consequently, there is no assurance that \$987,697 in incurred costs was a reasonable use of project funds.

The agent made unauthorized loans and withdrawals of residual receipts. We attribute these deficiencies to the agent's lack of cash controls and its unfamiliarity with the provisions in the regulatory agreements. As a result, \$349,703 in project funds was not available to pay for operating expenses of the project, and \$155,639 in residual receipts will not be available to fund future shortfalls.

In addition, the agent improperly disbursed project operating funds to pay expenses that were questionable and did not make a required payment to the residual receipts account or make a required equity payment in a timely manner. These deficiencies occurred because the agent's general manager did not have an understanding of HUD's rules and regulations. Consequently, the projects were deprived of \$142,785 in operating funds that would have been available to pay for other operating expenses of the project, the residual receipts account was underfunded by \$7,902, and a required equity payment was late.

### **What We Recommend**

We recommend that the Director of the Buffalo Office of Multifamily Housing instruct the owner and agent to develop procedures to ensure compliance with all terms of its regulatory agreement. We also recommend that HUD require the owner and agent to reimburse the projects for the ineligible costs associated with unauthorized loans and withdrawals from residual receipts, an improper salary advance, and excessive fees. Further, we recommend that HUD require the owner and agent to submit supporting documentation to justify the unsupported funds paid to the identity-of-interest company, unsupported salary expenses, and shared project expenses to enable HUD to make an eligibility determination.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We discussed the results of our review during the audit, provided a copy of the draft report to the auditee, and requested its comments on October 15, 2007. We held an exit conference on October 25, 2007 and the auditee provided their written comments on November 2, 2007, at which time they generally agreed with our findings. The auditee also provided attachments/exhibits with their comments that are not included in the report, but will be provided to the field office. Appendix B of this report contains the auditee's comments, along with our

evaluation of the comments. The names of specific individuals cited in the auditee comments have be expunged to protect their identities from improper disclosure.

# TABLE OF CONTENTS

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Background and Objectives	5
Results of Audit	
Finding 1: The Agent Did Not Support the Reasonableness of Payments Made to an Identity-of-Interest Company	6
Finding 2: The Agent Made Unauthorized Loans and Withdrawals of Residual Receipts	9
Finding 3: The Agent Used Project Funds to Pay Questionable Expenses That Were Not Reasonable and Necessary for Project Operations	13
Scope and Methodology	17
Internal Controls	18
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	20
B. Auditee Comments and OIG's Evaluation	21
C. Criteria	34

## **BACKGROUND AND OBJECTIVES**

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Richard A. Hutchens and Associates (agent) is the management agent for Cayuga Village (Project No. 014-35163) and Touraine Apartments (Project No. 014-35035). Cayuga Village is located in Cheektowaga, New York, and is composed of 80 units operating under the provisions of Sections 223(a)(7) and 221(d)(4) of the National Housing Act. Touraine Apartments is located in Buffalo, New York, and is composed of 104 units operating under the provisions of Section 221(d)(4) of the National Housing Act. The U.S. Department of Housing and Urban Development (HUD) insures the mortgages of both projects. The agent also manages Maple Ridge Estates, a HUD Section 8-subsidized project (Contract No. NY06H108007). Richard A. Hutchens is the owner of the agent, the managing general partner for Cayuga Village and Touraine Apartments, and has an identity-of-interest relationship with Tarico Brothers Construction (Tarico), a construction company that performed a variety of services at the projects.

Cayuga Village was referred to the HUD Office of Affordable Housing and Preservation for Mark-to-Market loan restructuring on September 21, 2001. Processing was completed and a full renewal contract was issued, effective June 1, 2003. Touraine Apartments was referred to the Office of Affordable Housing and Preservation for Mark-to-Market loan restructuring on July 14, 2004. Touraine's rents were reduced through a Mark-to-Market watchlist contract that was issued, effective October 1, 2005; however, at the conclusion of our on-site audit work, the loan had not yet closed, and processing was pending.

The objectives of our audit were to determine whether the agent used project funds in accordance with the regulatory agreement and HUD requirements. Specifically, we wanted to determine whether the agent (1) provided adequate documentation to support the reasonableness of payments made to an identity-of-interest company, (2) made loans and withdrawals of residual receipts that were authorized, and (3) disbursed project funds for expenditures that were reasonable and necessary.

## RESULTS OF AUDIT

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### Finding 1: The Agent Did Not Support the Reasonableness of Payments Made to an Identity-of-Interest Company

The agent did not solicit competitive bids or maintain adequate documentation when hiring an identity-of-interest company to perform repair and maintenance work for more than \$629,000 at Cayuga Village and more than \$358,000 at Touraine Apartments. This condition occurred because the agent failed to follow HUD regulations. As a result, the agent was unable to provide documentation indicating that all transactions were at arms length and that the services obtained were at the most reasonable and economical prices for the projects. Consequently, there is no assurance that \$987,697 in incurred costs was a reasonable use of project funds.

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#### **The Agent Paid \$629,018 in Questionable Costs from Cayuga Village**

The agent hired an identity-of-interest company, Tarico, to provide repair and maintenance services at Cayuga Village without soliciting competitive bids, resulting in \$629,018 in questioned costs that could have been available to pay for other operating expenses of the project. Some of the work performed at the project involved \$100,676 for new roofing installation and \$32,250 for electrical service installation in all of the project's buildings. Additional services provided by the company included monthly maintenance fees totaling \$61,101 and monthly grounds maintenance fees totaling \$27,701. The agent did not execute contracts for any of these services, nor did it solicit written cost estimates from at least three contractors or suppliers before selecting Tarico to do the work as required by HUD Handbook 4381.5, REV-2, CHG-2, paragraph 6.50. Thus, the agent was unable to support that these charges were reasonable.

The agent also hired Tarico to perform siding repair work at Cayuga Village with inadequate bid documentation. As part of its reserve for replacement withdrawal request to HUD for siding work, which was later denied, the agent submitted bid documents from four different companies. However, the general manager of the agent had a personal interest in three of the companies, including Tarico. Further, the core business of the remaining company that submitted a bid involved performing paving and not siding work. The bid document from Tarico, which was actually the invoice submitted to the agent for payment, indicated that materials and labor were to be provided at a cost of \$215,320; however, the company charged the project \$228,058 for materials and labor. Since the agent did not provide adequate documentation to support that Tarico was competitively

selected and that the costs paid were reasonable, the \$228,058 paid to Tarico is considered unsupported.

The agent also paid Cayuga Village interest on the unpaid invoices for the siding repair work and other services provided. These unreasonable finance charges totaled \$26,425 and resulted from the agent's not paying its expenses in a timely manner. Further, the identity-of-interest company was awarded a judgment on April 3, 2007, against the agent and the project for nonpayment of outstanding invoices. This action resulted in additional unreasonable costs of \$4,267, including interest and court costs. These unreasonable finance, interest and court costs are considered to be ineligible. In addition, there was \$148,540 in invoices from Tarico that was charged to Cayuga for items such as materials, snow removal, and additional maintenance costs that is considered unsupported. Since the agent did not provide adequate documentation to support the reasonableness of the invoices in question, the \$148,540 paid to Tarico is considered unsupported.

Overall, our review identified a total of \$629,018 in questioned costs that was charged to the Cayuga Village project. Of this amount, \$30,692 is considered ineligible and the remaining balance of \$598,326 is considered unsupported.

### **The Agent Paid \$358,679 in Questioned Costs from Touraine Apartments**

The agent also paid Tarico to provide repair and maintenance services at Touraine Apartments without submitting any competitive bid documentation, resulting in questioned costs of \$358,679. Although we were provided one contract pertaining to the services provided by the company at Touraine Apartments, the agent did not provide evidence that it solicited bids for the work to be performed before hiring the company. Work performed by Tarico included general maintenance, repairs, painting, and snow plowing. Invoices totaling \$129,265 were charged to Touraine; however, there is no evidence that the prices paid were reasonable. In addition, on April 3, 2007, Tarico was awarded a judgment against the agent and Touraine Apartments for nonpayment for services provided at Touraine Apartments in the amount of \$229,414. Of this amount, \$225,572 in unpaid invoices are considered unsupported since there is no evidence to support the reasonableness of the costs paid, and \$3,337 in interest and \$505 in court costs are ineligible costs. Overall, \$358,679 in questioned costs was charged to Touraine Apartments. Of this amount, \$3,842 is considered ineligible and the remaining balance of \$354,837 is considered unsupported.

## Conclusion

The agent did not solicit competitive bids to support that it paid the lowest rates available when hiring Tarico to perform repair, maintenance, and other work at Cayuga Village and Touraine Apartments. Consequently, the agent cannot assure HUD that the use of the identity-of-interest company was cost effective. Thus, the projects may have been deprived of \$987,697 in funds (\$629,018 for Cayuga and \$358,679 for Touraine) that could have been used for other reasonable and necessary operating expenses.

## Recommendations

We recommend that the Director of the Buffalo Office of Multifamily Housing instruct the owner and agent to

- 1A. Develop procedures to ensure compliance with all terms and conditions of its regulatory agreements and HUD rules and regulations that require soliciting bids; obtaining cost estimates for procuring contracts for materials, supplies, and services; and obtaining and maintaining contracts with all service providers.
- 1B. Reimburse the projects' operating account from nonproject funds \$34,534 for the ineligible finance charges, interest and court costs paid (\$30,692 for Cayuga Village and \$3,842 for Touraine Apartments).
- 1C. Provide supporting documentation for the \$598,326 in contract costs charged to Cayuga Village. If any amounts are deemed ineligible, they should be repaid or the payable should be removed from the project's books.
- 1D. Provide supporting documentation for the \$354,837 in contract costs charged to Touraine Apartments. If any of the amounts are deemed ineligible, they should be repaid or the payable should be removed from the project's books.

## Finding 2: The Agent Made Unauthorized Loans and Withdrawals of Residual Receipts

The agent made unauthorized loans of project funds to (1) the managing general partner, (2) an identity-of-interest company, and (3) other projects. Also, the agent acquired debt from other projects and the managing general partner without requesting authorization from HUD. Further, the agent made unauthorized withdrawals from the residual receipts account. We attribute these deficiencies to the agent's lack of cash controls and its unfamiliarity with the provisions in the regulatory agreements. As a result, \$349,703 in project funds was not available to pay for operating expenses of the project. In addition, \$155,639 in residual receipts will not be available to fund future shortfalls.

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### Unauthorized Loans Were Made to the Managing General Partner

The agent made \$71,065 in loans from project funds (\$69,495 for Cayuga Village and \$1,570 for Touraine Apartments) to Richard A. Hutchens and his related companies. Richard A. Hutchens is a principal of the agent and the managing general partner of Cayuga Village and Touraine Apartments. The regulatory agreement provides that the owner shall not pay out any funds except for reasonable operating expenses or encumber any personal property of the project without written approval from HUD. The agent loaned \$49,065 in project funds by paying the expenses of Richard A. Hutchens and his related companies. These funds were used to pay for legal fees, payroll expenses, and the American Express account of the agent. Also, these funds were used to pay Richard A. Hutchens' personal equity credit line and the expenses of his companies not related to the project. In addition, the agent made \$22,000 in loans via wire transfers and checks from Cayuga Village's project funds to the agent's bank accounts. The agent did not provide documentation or explain the reason for these transactions.

### Unauthorized Loans Were Made to an Identity-of-Interest Company

The agent made \$60,540 in loans from Cayuga Village's project funds to an identity-of-interest company, Tarico, in violation of the regulatory agreement. The agent allowed Tarico to have access to the credit cards of the projects managed by the agent. In turn, the company used those credit cards to charge items that related to its own business expenses, not project-related expenses. For example, Cayuga Village's operating funds were used to pay for 41 credit card invoices that included expenses that did not relate to Cayuga Village but, rather, to Tarico. Therefore, these amounts are considered to be loans, which are ineligible and should be repaid to the project.

### **Unauthorized Loans Were Made to Other Projects**

The agent made \$106,405 (\$105,916 for Cayuga Village and \$489 for Touraine Apartments) in loans from project funds to other projects in violation of the regulatory agreement. For the most part, the loans represented Cayuga Village's operating funds that were used to pay expenses of five other projects that were managed by the agent for such items as materials from Home Depot, office copier services, and elevator maintenance services. The agent made \$66,835 in unauthorized loans of Cayuga Village project funds to Touraine Apartments and \$34,172 in unauthorized loans of Cayuga Village project funds to Apple Blossom Acres. The remaining \$5,398 in loans represented the agent's making loans with Cayuga project funds to three other projects and making loans with Touraine project funds to one project.

### **The Agent Acquired Debt without Authorization from HUD**

The agent encumbered the projects with \$111,693 (\$38,515 for Cayuga Village and \$73,178 for Touraine Apartments) in unauthorized loans. Of this amount, \$77,932 pertained to the agent's borrowing from other projects managed by the agent to pay expenses owed by Touraine Apartments and Cayuga Village. The regulatory agreement provides that the owner cannot encumber personal property of the project without written approval from HUD. The agent paid for \$73,178 in Touraine Apartments' expenses through the use of four other projects' funds managed by the agent. The agent believed this practice was needed to keep Touraine Apartments afloat due to (1) the lack of operating funds available since operating under a Mark-to-Market watchlist contract and (2) a structural problem in the building that was not covered by insurance. To encourage owners to make advances to projects in critical situations, HUD may approve on a case-by-case basis requests to make advances and for repayment of such advances on a monthly basis as provided by HUD Handbook 4370.2 paragraph 2-11B. The agent did not obtain approval from HUD before encumbering the projects. The agent encumbered Cayuga for the remaining \$4,754 in loans when it allowed two projects to pay for expenses of Cayuga Village.

In addition, the agent encumbered Cayuga Village when the agent paid \$33,761 for siding materials on behalf of Cayuga Village. It appears that the agent paid these amounts because it was named in a lawsuit in which the vendor was awarded a judgment. Nevertheless, the agent should not have encumbered the project without first obtaining HUD approval.

### **Withdrawals from the Residual Receipts Accounts Were Made without HUD Approval**

The agent made \$155,639 in withdrawals from Touraine Apartments' residual receipts accounts without HUD approval as required by the regulatory agreement, paragraph 2(c). The funds were used to pay vendors and cover bank charges of Touraine Apartments. The agent did not provide a reason why HUD approval was not obtained before the withdrawals were made. During an interview, the independent public accountant expressed disbelief that the agent attempted to obtain HUD approval since the residual receipts were not in a HUD-controlled account, and, thus, it was not necessary. However, the regulatory agreement requires that the receipts be under the control of HUD and be disbursed only on the direction of HUD for purposes that HUD determines. The residual receipts fund should be available to fund items such as mortgage shortfalls and operating deficiencies, as such unauthorized withdrawals can lead to potential management shortfalls and mortgage defaults. Thus, the residual receipts account was underfunded by \$155,639 due to the withdrawals that were not approved by HUD.

### **Conclusion**

The agent made advances of project funds and encumbered the projects with loans without authorization from HUD. Consequently, \$349,703 in loans of project funds was not available to pay for operating expenses of the project. Of this amount, the agent will need to reimburse the projects' operating accounts \$238,010 and repay \$111,693 in unauthorized loans from nonproject funds. In addition, \$155,639 in withdrawals of residual receipts is considered ineligible. Therefore, residual receipts funds are not available to fund items such as mortgage shortfalls and operating deficiencies, thereby effecting the future management of the project.

### **Recommendations**

We recommend that the Director of the Buffalo Office of Multifamily Housing instruct the owner and agent to

- 2A. Develop procedures and implement controls that will ensure compliance with all terms and conditions of their regulatory agreements.
- 2B. Discontinue the practice of using project funds to pay for the expenses of other projects.

- 2C. Discontinue making withdrawals from the residual receipts account without prior written approval from HUD and develop procedures to ensure that the residual receipts account is properly funded.
- 2D. Reimburse the projects' operating accounts from nonproject funds \$238,010 (\$235,951 for Cayuga Village and \$2,059 for Touraine Apartments) for ineligible advances of project funds.
- 2E. Repay from non project funds \$111,693 (\$38,515 for Cayuga Village and \$73,178 for Touraine Apartments) for unauthorized loans and if any amount has been paid from project funds, the agent should be instructed to reimburse the operating account.
- 2F. Obtain approval from HUD or reimburse the residual receipts account of Touraine Apartments from nonproject funds \$155,639 for the unauthorized withdrawals.

### Finding 3: The Agent Used Project Funds to Pay Questionable Expenses That Were Not Reasonable and Necessary for Project Operations

The agent improperly disbursed operating funds of Cayuga Village and Touraine Apartments to pay expenses that were questionable and did not make a required payment to the residual receipts account or make a required equity payment in a timely manor. Specifically, the agent (1) disbursed \$60,267 in ineligible and unsupported salary expenses, (2) improperly allocated \$47,852 in shared expenses, (3) collected \$34,666 in excessive management fees, (4) did not make a required deposit of \$7,902 to the residual receipts account, and (5) failed to pay \$91,650 owed under the mortgage restructuring note in a timely manner. These deficiencies occurred because the agent's general manager did not have an understanding of HUD's rules and regulations. Consequently, the projects were deprived of \$142,785 in operating funds that would have been available to pay for other operating expenses of the project, the residual receipts account was underfunded by \$7,902, and a required equity payment was late.

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#### The Agent Disbursed Ineligible and Unsupported Salary Expenses

The agent disbursed \$60,267 in ineligible and unsupported salary expenses as follows:

##### Improper Advance

The agent loaned an employee of the agent \$5,000 from Cayuga Village's operating account. This is an ineligible use of project funds. In turn, the agent reduced its employee's paycheck by \$100 for the next 50 weeks. However, the agent did not reimburse the project for the reimbursements it received.

##### Unsupported Salary

The agent charged Cayuga Village and Touraine Apartments \$55,267 in unsupported salary expenses. The agent charged employees' gross wages to the projects and then added an additional amount to cover other employee fringe benefits. The additional amount was calculated at 29 to 30 percent of gross wages. The agent provided us a list of expenses covered under the percentages. One of the largest items was New York state unemployment insurance, which made up 9.4 percent of the amount. However, New York state unemployment insurance was only charged for the first \$8,500 of the employees' gross wages. Thus, when the employee earned \$8,500, the agent was no longer being charged this amount, but the agent continued to charge the projects. Also, the agent identified that 11.5 percent of this amount was for workman's compensation

insurance. However, the agent did not provide support indicating the amount paid. Therefore, the \$55,267 is unsupported.

### **The Agent Improperly Allocated Shared Expenses**

The agent did not properly allocate \$47,852 for items such as telephone, insurance, and maintenance expenses. Although the agent managed other properties, it shared office space with Touraine Apartments; however, the agent did not have an allocation plan that identified what expenses were shared between its projects and the management company. The agent also had not identified which expenses it shared with Touraine Apartments to support the reasonableness of the \$47,852 charged to Touraine Apartments. As a result, this amount is considered to be unsupported.

### **The Agent Collected Excessive Management Fees**

The agent overcharged Cayuga Village \$27,199 and Touraine Apartments \$7,467 in management fee expenses. The agent charged the projects a set rate each month, which was more than the agent earned. This condition occurred because the agent provided the accountants the wrong fee percentages. The calculation of the management fee by the independent public accountants was based on a 6.75 percent fee for Cayuga Village and a 6.5 percent fee for Touraine Apartments, when the agreed-upon fee in the management certification for both projects was 6.25 percent of residential income collected. As a result, \$34,666 in excessive management fees was charged to the projects during the period between January 1, 2004, and December 31, 2006.

### **The Agent Did Not Make a Required Deposit to the Residual Receipts Account**

The agent did not make a required deposit of \$7,902 to the residual receipts account of Touraine Apartments based upon the computation of surplus cash as of December 31, 2003. The regulatory agreement provides that the residual receipts shall be deposited within 60 days after the end of the fiscal period. However, although funds were available March 1, 2004, the agent did not make the required residual receipt payment. Therefore, HUD should ensure that the agent deposits this amount into Touraine's residual receipt account.

### **The Agent Did Not Make the Necessary Mortgage Payments in a Timely Manner**

The agent failed to make \$91,650 in mortgage payments on the mortgage restructuring note in a timely manner. The \$91,650 was due on April 1, 2005, according to the multifamily mortgage account statement. The agent provided us the multifamily mortgage account statements through April 20, 2007, all of which indicated that the amount was due. However, the agent's general manager claimed that he was not aware of the amounts due. After we discussed this matter with HUD staff, HUD issued a formal letter on June 14, 2007 advising that the agent was in violation of its regulatory agreement and mortgage restructuring note. In response, the agent made the \$91,650 payment on July 23, 2007. However, this amount may have been recorded on the project's books as a payable to the agent.

### **Conclusion**

The agent improperly disbursed operating funds of Cayuga Village and Touraine Apartments to pay expenses that were questionable. Consequently, \$39,666 in ineligible expenses should be repaid, \$7,902 should be deposited into Touraine's residual receipts account, and the agent needs to provide support for \$103,119 so that HUD can make an eligibility determination.

### **Recommendations**

We recommend that the Director of the Buffalo Office of Multifamily Housing instruct the owner and agent to

- 3A. Develop procedures to ensure that the agent will abide by all terms and conditions of the regulatory agreements that require project funds to be expended only for reasonable and necessary expenses and residual receipt deposits and mortgage payments to be made in a timely manner.
- 3B. Reimburse the projects' operating account from nonproject funds \$39,666 for the ineligible employee advance and excessive management fees paid (\$32,199 for Cayuga Village and \$7,467 for Touraine Apartments).
- 3C. Provide appropriate supporting documentation for the \$55,267 in salary expenses or reimburse the project account(s) from nonproject funds (\$26,779 for Cayuga Village and \$28,488 for Touraine Apartments).

- 3D. Provide supporting documentation for the allocated \$47,852 in unsupported/shared expenses charged to Touraine Apartments or reimburse the project from nonproject funds.
- 3E. Establish a cost allocation plan that would ensure an equitable distribution of any shared expenses. Procedures should allow for a new allocation plan to be computed on an annual basis.
- 3F. Reimburse the residual receipts account of Touraine Apartments from nonproject funds \$7,902 for the funds that were not deposited.
- 3G. Provide evidence that the \$91,650 payment for the mortgage restructuring note was properly recorded.

## SCOPE AND METHODOLOGY

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Our review focused on whether the agent used project funds in accordance with regulatory agreements and HUD requirements. To accomplish our objectives, we interviewed auditee personnel and HUD officials. In addition, we reviewed regulatory agreements, applicable HUD regulations, and the agent's management certifications. We examined the projects' financial records by downloading and analyzing the projects' Quickbook files and selecting those transactions that related to our audit objectives. We reviewed the audited financial statements prepared by the projects' independent public accountants. We also reviewed information obtained from HUD's Real Estate Management System and Financial Assessment Subsystem.

The review covered the period from January 1, 2004, through December 31, 2006, and was extended as necessary. We performed audit work from January through July 2007 at the offices of the agent located in Buffalo, New York.

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

# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding of resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The agent did not have an adequate system to ensure compliance with the regulatory agreement or laws and regulations when it did not ensure the reasonableness of payments to an identity-of-interest company, made unauthorized loans and withdrawals of residual receipts, and made questionable disbursements of project operating funds (see findings 1, 2, and 3).
- The agent did not have an adequate system to ensure that resources were properly safeguarded when it charged questionable expenditures to the projects and allowed unauthorized loans and disbursements of project funds (see findings 2 and 3).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1B	34,534		
1C		598,326	
1D		354,837	
2D	\$238,010		
2E	\$111,693		
2F	\$155,639		
3B	\$39,666		
3C		\$55,267	
3D		47,852	
3F	\$7,902		
3G			\$91,650
Total	\$587,444	\$1,056,282	\$91,650

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, the payment of the outstanding mortgage amount represents funds to be put to better use because it paid an overdue liability and the payment reduced the risk to HUD's insurance fund.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

RICHARD A. HUTCHENS & Associates

274 DELAWARE AVENUE  
BUFFALO, NEW YORK 14202  
716-847-0169  
FAX: 716-847-0171

November 2, 2007

US Department of Housing and Urban Development  
Office of Inspector General, Buffalo HUB  
Attn: Paul Zausen, Patrick Anthony  
465 Main Street  
Buffalo, NY 14202

Re: Richard A. Hutchens and Associates, Management Agent, Buffalo, NY, Used  
Project Funds for Ineligible/Unsupported Costs – Cayuga Village and Touraine  
Apartments

Dear Mr. Zausen and Mr. Anthony:

We are in receipt of the draft audit performed by your office. In response to your  
findings, we would like to formally state the following:

In July 2007, a meeting was held involving Richard A. Hutchens, Managing Partner,  
The Bonadio Group (our independent auditing firm), [REDACTED] and  
[REDACTED] Richard A. Hutchens Associates Staff

At that time, it was brought to our attention that there were significant concerns  
and compliance issues in relation to alleged violations of the regulatory agreements:  
specifically, (A) financial practices that were in place as a result of the direction of the  
General Manager, [REDACTED]. Mr. [REDACTED] was hired in 2001, and was  
responsible for all direct oversight of the management of Touraine Apartments and  
Cayuga Village in 2003, including the project's accounting processes and financial  
practices, as Mr. Hutchens was recovering from an illness. Despite the fact that the  
Inspector General's office had been on-site since February 2007, it was not until this  
meeting took place that information was relayed (in Mr. [REDACTED] absence), to Mr.  
Hutchens, (the Owner) which defined the gravity of the situation.

The Owner concedes that the practices and standards directed by Mr. [REDACTED]  
constituted serious deficiencies and noncompliance with acceptable standards dictated by  
the General Accounting Office (GAO), AIPCA Generally Accepted Accounting  
Principles (GAAP), the Office of Management and Budget (OMB), and HUD, including:

1. Direct obstruction of the system of internal controls required by Richard A. Hutchens and Associates by overriding the segregation of duties in place to prevent unauthorized transactions.
2. Requiring office staff to comply with his directives and preventing staff from reporting their concerns about improper practices to the Owner.

Comment 1

Comment 2

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

#### Comment 2

3. Failing to comply with the terms of the above referenced properties Regulatory Agreements.
4. Authorizing contracts and approving work to be performed without soliciting competitive bids.
5. Approving unauthorized loans between the projects and on behalf of the Owner without the Owner's consent or knowledge.
6. Distributing company credit cards and approving charges not related to the projects without the knowledge of the Owner.
7. Authorizing withdrawals from project residual receipts accounts without the Owner's knowledge and without requesting agency approval.
8. Allowing a lawsuit to proceed against the projects and the management company without the Owner's knowledge and without notifying our legal counsel.
9. Failing to make required mortgage loan payments in a timely manner.

Mr. [REDACTED] has since been removed from all duties relating to any of the entities managed by or affiliated with Richard A. Hutchens and Associates as a result of these findings. Any authorization which he may have had regarding access to the financial operations of any entity associated with Richard A. Hutchens and Associates has been terminated. Mr. Richard A. Hutchens has once again assumed the role of direct oversight of all practices and procedures involving all of our federally subsidized housing projects and is working directly with Ms. [REDACTED] and Ms. [REDACTED] on correcting all non-compliance issues.

#### Comment 3

As a result, the company has instituted internal control practices and implemented an anti-fraud, inventory and control system to safeguard assets. Federal guidelines are being followed for implementing and awarding contracts and major improvement projects relating to all properties managed by Richard A. Hutchens and Associates. An allocation plan is being developed in order to assure that there is an equitable distribution of any shared expenses between the Management Agent and Touraine Apartments, as they share common office space. A formal written Management Plan is being drafted to specifically denote authorization issues, the chain of command, and specific duties of every employee.

#### Comment 4

(A) The issue of the improperly advanced funds was satisfied, per HUD'S Office of Affordable Housing Preservation, prior to the closing of Touraine Apartment's Mark-to-Market restructuring in August 2007.

(B) The payroll concerns are currently being analyzed.

(C) The 30% surcharge has been researched and is addressed in further in this response.

(D) Research is being conducted on the ineligible and unsupported charges, and documentation has been partially completed to support these expenses as being eligible.

#### Comment 3

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

#### Comment 3

(E) Partial payment on withdrawals from the Residual receipts accounts has been made, and the owner would like to take the opportunity to collect supporting documentation and submit a supplemental response to HUD as the withdrawal was made to pay Touraine's project expenses during the time period that it was operating without a subsidy.

Due to the voluminous nature of the documentation required to research and properly support the issues stated in the draft audit, the Owner hereby submits the following initial draft audit responses with the request that HUD Inspector General a supplemental response to further document our findings and conclusions.

#### Comment 5

The Owner wishes to make HUD fully aware that there are questions and concerns regarding the legal validity of the Owner's relationship with the alleged identity-of-interest company referenced in the draft audit report. The owner is presently securing legal counsel regarding this matter. The Owner intends to pursue this matter legally on behalf of Richard A. Hutchens Associates, Touraine Apartments and Cayuga Village in any appropriate manner that may fall under any applicable legal statute, including any reimbursement owed under the Federal, State, or Local Law.

#### Comment 6

The Owner further wishes to make HUD fully aware that as of today's date, the Owner has personally already paid \$733,245.04 on behalf of Cayuga Village and Touraine Apartments:

09/18/05	\$7,800.00
12/01/06	\$55,569.54
01/17/07	\$165,000.00
04/16/07	\$200,000.00

B&L Wholesale Lawsuit for siding for Cayuga	\$33,761.23	
Deposit into Touraine Residual Receipt Account	\$19,000.00	(7/20/07)
Deposit into Touraine Residual Receipt Account	\$1,904.00	(7/23/07)
Check from Richard A. Hutchens to Federal		
Housing Administration for Cayuga Surplus cash	\$91,650.00	(7/23/07)
Wire transfer to the Talon Group for the M2M		
Closing on Touraine Apartments	\$77,896.27	(8/27/07)
Payroll covered by Owner on Touraine Apartments		
behalf from 8/2006 - 8/2007	\$80,574.00	

Documentation showing these payments by the Owner can be found in Exhibit A.

Finding 1.A Develop procedures to ensure compliance with all terms and conditions of regulatory agreements and HUD rules and regulations that required soliciting bids, obtaining cost estimates for procuring contracts for materials, supplies and services; and obtaining and maintaining contracts with all service providers.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

#### Comment 7

Owner's response:

Hutchens and Associates has reinstated our policy of requiring a minimum number of three bids for all major services and contracts. Regular materials and supplies ordered are placed after several price comparisons are made to assure the cost to the project is reasonable and the project is procuring the highest quality materials for the lowest cost.

Finding 1.B. Reimburse the project's operating account from nonproject funds \$34,534 for the ineligible finance charges, interest and court costs paid (30,692 for Cayuga Village and \$3,842 for Touraine Apartments).

#### Comment 8

Owner's response:

The owner is in the process of consulting legal counsel in order to determine if these costs may be reclaimed through formal legal action against Tarico Brother Construction.

Finding 1.C. Provide supporting documentation for the \$598,326 in contract costs charged to Cayuga Village. If any amounts are deemed ineligible, they should be repaid, or the payable should be removed from the projects books.

Roofs	\$100,676
Electrical	\$32,250
Monthly Maintenance	\$61,101
Grounds	\$27,701
Siding job	\$228,058

Finance Charges	\$26,425
Court Costs	\$4,267
Ineligible	\$30,692
Additional Maint.	\$148,540

Owner's Response:

In regards to the ineligible costs for finance charges, the Owner is in the process of consulting legal counsel in order to determine if these costs may be reclaimed through formal legal action against Tarico Brothers Construction. The lawsuit was filed and satisfied while the owner was out of state, and the owner was not made aware of the pending suit. Owner's legal counsel was not notified of pending litigation and a defense was never made on the projects behalf due to the actions of the General Manager.

#### Comment 9

#### Comment 10

The owner has collected supportive documentation in order to justify the expenses paid for monthly maintenance and additional maintenance fees,

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

#### Comment 10

which were paid to cover the day-to-day duties of maintaining the property. Additional work orders were collected from the property and are matched to invoices to prove work was in fact completed. (See Exhibit B)

#### Comment 3

Comparison bids will be collected to determine if the amounts paid for electrical, roofing, and grounds were in fact reasonable considering the work performed and will be forwarded to the agency upon receipt.

#### Comment 11

In regards to the siding invoices, the owner is in the process of consulting with legal counsel in order to reclaim some or all of the costs as a result of legal concerns and issues against the contractor. In addition, the owner provided the project \$165,000 in 2006 to pay costs associated with the siding invoices and other bills to Tarico Brothers.

Finding 1.D. Provide supporting documentation for the \$354,837 in contract costs charged to Touraine Apartments. If any of the amounts are deemed ineligible, they should be repaid or the payable should be removed from the project's books.

Owner's response:

#### Comment 9

In regards to the ineligible costs for finance charges and court fees, the Owner is in the process of consulting legal counsel in order to determine if these costs may be reclaimed through formal legal action against Tarico Brothers. The lawsuit was filed and satisfied while the owner was out of state, and the owner was not made aware of the pending suit. Owner's legal council was not notified of pending litigation and a defense was never made on the projects behalf due to the actions and inactions of the General Manager.

#### Comment 12

In regards to the remainder of the costs for maintenance, repairs, and snow plowing:  
The night maintenance contract constituted the same work performed by the security guard contract, which had been awarded to US Security Associates. While bids were not submitted to award the contract, US security charged \$ 66,906 in 2002 to provide this service. Exhibit C provides a sample of documentation on site proving the presence of Tarico performing the security guard work in the form of Collects Pen reports and incident reports. Bids were submitted and approved by HUD this year with US Security being awarded the contract.

#### Comment 13

In addition, the night maintenance staff also removed all trash from the building and shoveled and salted the walkways in the winter, a position

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

#### Comment 13

previously performed by a tenant for a nominal fee. Liability issues in allowing a tenant to perform these duties were a concern, and the duties of security, shoveling and trash removal were combined under the umbrella of night maintenance. While bids were not procured at the time, subsequent bids have been obtained by management in 2006 and 2007 that were submitted to HUD for approval.

#### Comment 14

The cleaning contract was for full-time cleaning services billed at a rate of \$ \$425weekly, with an annual cost of \$22,100. There was an increase in 2006 to \$442 per week with an annual cost of \$22,984. This was the cost for full time cleaning services of the common areas of the building. The previous contractor, All Family Cleaning, charged \$19,680 annually to perform this work. While additional bids were not obtained at the time, the Owner obtained bids in 2006/2007 ranging from 12,999.96 for a part-time cleaner, to \$26,779.92 for full time services.

#### Comment 15

Additional maintenance fees were charged as Touraine Apartments employed an additional part time maintenance man to assist American Cleaning and Maintenance in the general daytime maintenance duties, including apartment/building work orders and make readies. The individual employed was on Tarico Brothers payroll. He worked 20-25 hours per week, and the project reimbursed Tarico for his salary. The project is in possession of proof of his work at this site in the form of work orders and make readies completed by him.

Finding 2.A. Develop procedures and implement controls that will ensure compliance with all terms and conditions of their regulatory agreements.

Owner's response:

#### Comment 7

Please see owner's response to item 1.A above for initial corrective measures taken. In addition, the owner is in the process of implementing a written plan for a system of internal controls to ensure future compliance. Since July 2007 the owner has adopted the following measures, which will be formally included in the owner's supplemental written compliance plan to be submitted to HUD:

1. No checks are processed without two authorized signatures
2. All invoices are reviewed prior to payment will not be authorized without supporting documentation that product was received or work was completed (Packing slips/register receipts/ site manager written confirmation).
3. Checks are compared to invoices at signatory stage to assure accuracy of payment and provide final authorization of payment.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

**Comment 7**

Finding 2.B. Discontinue practice of using project funds to pay for the expenses of other projects.

Owner's Response: This practice was discontinued effective July 2007, when the owner was made fully aware that this practice was occurring under the direction of the then General Manager.

**Comment 7**

Finding 2.C. Discontinue making withdrawals from the residual receipts account without prior written approval from HUD and develop procedures to ensure that the residual receipts account is properly funded.

Owner's Response: This practice was discontinued effective July 2007

**Comment 16**

Finding 2.D. Reimburse the project's operating accounts from non-project funds \$238,010 (235,951 for Cayuga Village and \$2059 for Tourane Apartments for ineligible advances of project funds.

Finding 2.E. Repay the unauthorized loans of \$111,693 (\$38,515 for Cayuga Village and \$73,178 for Touraine Apartments) from non-project funds. If any of these loans have been paid from project funds, the agent should be instructed to reimburse the projects operating account.

Owner's Response: The ineligible advances and loans were cleared from the project's books in the course of completing the M2M restructuring on Touraine Apartments and was a condition of closing enforced by OAHP. Collection of any monies allegedly owed to the owner has been waived. The amount for Cayuga Village was \$165,000, and Touraine was \$92,835.00 .

**Comment 17**

Finding 2.F. Obtain approval from HUD or reimburse the residual receipts from non-project funds \$155,639 for the unauthorized withdrawals.

Owners Response. Partial reimbursement was made in order to facilitate the closing on Touraine Apartments, and the Owner will apply for HUD approval of the bills that were paid covering the balance.

Finding 3.A. Develop procedures to ensure that the agent will abide by all terms and conditions of the regulatory agreements that require project funds to be expended only for reasonable and necessary expenses and residual receipts deposits and mortgage payments to be made in a timely manner.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

**Comment 7**

Owner's Response: Finding 3.A. has been addressed in Owners response to numerous above findings

Finding 3.B. Reimburse the project's operating accounts from non-project funds \$39,666 for the ineligible employee advance and excessive management fees paid (32,199 for Cayuga Village and \$7,467 for Touraine Apartments).

**Comment 18**

Owner's Response: The owner believes that there were two HUD 9839 forms in circulation for each project at that time, and there was confusion, both at our office and HUD as to which form supported the correct management fee. We are currently researching our files to determine the source of this error in order to correct the situation. The owner has waived \$24,710 in uncollected management fees for Touraine Apartments in order close the M2M restructuring.

Finding 3.C. Provide appropriate supporting documentation for the \$55,267 in salary expenses or reimburse the project account(s) from non-project funds (\$26,779 for Cayuga Village and \$28,488 for Touraine Apartments).

**Comment 19**

Owner's Response: The Owner has researched the 30% surcharge. It has been found that the surcharge was implemented by the prior General Manager, Anthony Illos, and was an estimated figure of the employer portion to match Social Security, Unemployment and FUTA.

Effective with payroll November 1, 2007, the owner will not collect 30% surcharge until the payroll report is received from the payroll company. Future charges will reflect exactly what is shown on the payroll report.

Finding 3.D. Provide supporting documentation for the allocated \$47,852 in unsupported/shared expenses charged to Touraine Apartments or reimburse the project from non-project funds.

**Comment 20**

Owner's Response: The shared expenses charged to Touraine Apartments are comprised of and approximate 50/50 split between the property and the Owner for items such as telephone service, office products and postage. More complete documentation of these expenses will be provided in our supplemental allocation plan.

Finding 3.E. Establish a cost allocation plan that would ensure an equitable distribution of any shared expenses. Procedures should allow for a new allocation plan to be computed on an annual basis.

**Comment 7**

Owner's Response: A formal allocation plan will be completed by January 1, 2008 and will be computed on an annual basis thereafter.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

**Comment 7**

Finding 3.F. Reimburse the residual receipts account of Touraine Apartments from non-project funds \$7,902 for the funds that were not deposited.

Owner's Response: Once the deposit information is obtained, it will be forwarded to the Agency for review.

**Comment 21**

Finding 3.G. Provide evidence that the \$91,650 payment for the mortgage-restructuring note was properly recorded.

Owner's Response: A copy of cancelled check and statement from Prudential showing payment is included in Exhibit A.

Thank you for accepting our initial response. A supplemental response will be forthcoming addressing any items needing further documentation.

Sincerely,



Richard A. Hutchens  
Owner

Enclosures:

Attachment A  
Attachment B  
Attachment C

## OIG Evaluation of Auditee Comments

- Comment 1** Officials for the agent contend that the significant concerns and compliance issues regarding violations of the regulatory agreement were not brought to the attention of the owner of the agent, Richard A. Hutchens, until July 2007. However, it should be noted that throughout the course of our onsite audit work from January 2007 through July 2007, officials for the agent were kept informed of our concerns. In addition, a pre-exit conference meeting was held with the owner of the agent and the general manager on June 26, 2007 informing both officials of the violations of the regulatory agreement and other significant concerns identified during our review. Thus, this report should come as no surprise.
- Comment 2** The owner concedes that the actions of the general manager constitute serious deficiencies pertaining to internal control procedures, compliance with the regulatory agreements, compliance with procurement procedures, unauthorized loans, usage of company credit cards, unauthorized withdrawals from the residual receipts accounts, and not making the required mortgage loan payments in a timely manner. While the owner appears to have taken action to remove the general manager believed to be the cause for the deficiencies identified in the report, ultimately the owner of the project is responsible for complying with the regulatory agreement and HUD rules and regulations pertaining to the projects.
- Comment 3** The actions being taken by the owner/agent are responsive to our recommendations. While we encourage the agent to continue to research documentation to support the ineligible and unsupported charges, future correspondence and support should be directed to HUD to be considered during the audit resolution process.
- Comment 4** The actions being taken by the owner/agent are responsive to our recommendations. However, although officials contend that the issue of improperly advanced funds was satisfied prior to the closing of Touraine Apartment's Mark-to-Market restructuring in August 2007; through the completion of our onsite audit work, it could not be determined whether the improperly advanced funds were properly reimbursed and resolved.
- Comment 5** Officials for the agent contend that there are questions and concerns regarding the legal validity of the owner's relationship with the alleged identity-of-interest company, for which the owner is securing legal counsel regarding this matter. However, during our review, we determined that the owner had an identity-of-interest relationship with Tarico Brothers Construction.
- Comment 6** Officials for the agent state that the owner has personally paid \$733,245.04 on behalf of Cayuga Village and Touraine Apartments and provided documentation supporting these payments. However, our review noted that although the owner made various payments (wire transfers, etc.) the documentation provided was not

adequate to determine whether the payments addressed the costs questioned in this report. As such, the owner should work with HUD during the resolution process to resolve these issues.

- Comment 7** The actions taken are responsive to our findings and/or recommendations.
- Comment 8** Officials for the agent are in the process of consulting with legal counsel to determine whether these costs may be reclaimed through formal legal action against Tarico Brothers Construction. However, although formal legal action is being sought, it is the responsibility of the project owner to reimburse the project's operating account from non project funds.
- Comment 9** Officials for the agent state that they were not made aware of the lawsuit which resulted in the finance charges and court costs charged to Cayuga Village and Touraine Apartments. Further, the owner's legal counsel was not notified of the pending litigation and a defense was never made on the projects behalf due to the actions of the general manager. While this may be true, the project owner is responsible to reimburse all ineligible costs incurred.
- Comment 10** Officials for the agent provided documentation to justify the expenses paid for monthly maintenance and additional maintenance fees at Cayuga Village. We reviewed the documentation submitted subsequent to our review and noted that although work orders for the maintenance work performed was provided, there is no documentation to support the reasonableness of the payments made to Tarico Brothers Construction. Thus, the \$598,326 in identity-of-interest expenses at Cayuga Village is still considered unsupported due to lack of bid documents and inadequate procurement procedures.
- Comment 11** Officials for the agent state that they are consulting with legal counsel to determine whether the unsupported charges pertaining to the siding work can be reclaimed through formal legal action against the identity-of-interest construction company. Officials further contend that the owner provided the project \$165,000 in 2006 to pay costs associated with the siding invoices and other bills to the identity-of-interest company, however during our review we found no evidence to support that the owner provided the \$165,000 to pay for the costs in question.
- Comment 12** Officials for the agent concur that bids were not submitted regarding the maintenance, repair, and snow plowing work performed at Touraine Apartments. However, officials submitted documentation to provide evidence of the identity-of-interest company performing the security guard work. We have reviewed the documentation subsequently submitted and noted the absence of bid documents. Further, the information that was provided does not support that the services in question were obtained at the most reasonable and economical price for the project. While we encourage the agent to submit appropriate supporting bid documentation to HUD from this point forward, procurement procedures were not followed during our audit period and thus, the costs remain unsupported.

- Comment 13** Officials for the agent concur that bids were not procured regarding the night maintenance services provided at Touraine Apartments. These services were previously performed by a tenant for a nominal fee however due to liability issues the duties were combined under the umbrella of night maintenance. Subsequent bids have now been obtained and were submitted to HUD for approval. Our review disclosed that procurement procedures were not followed during the audit period and bids were not procured at the time, thus, the costs incurred remain unsupported.
- Comment 14** Officials for the agent concur that bids were not submitted regarding the cleaning services provided at Touraine Apartments. While we encourage the agent to submit appropriate bid documents to HUD in the future, procurement procedures were not followed during our audit period; therefore, the costs associated with the cleaning contract remain unsupported.
- Comment 15** Officials for the agent state that additional maintenance fees were charged as Touraine Apartments employed an additional part time maintenance employee to assist American Cleaning and Maintenance in the general daytime maintenance duties including apartment /building work orders and make readies. It is our contention that while the agent may be able to provide work orders for the work completed, there are no procurement documents to support the reasonableness of the work performed. Procurement procedures were not followed and accordingly, the additional fees paid remain unsupported.
- Comment 16** Officials for the agent contend that the issues of improperly advanced funds and unauthorized loans were satisfied prior to the closing of Touraine Apartment's Mark-to-Market restructuring. However, during the course of our review, it could not be determined whether the improperly advanced funds and unauthorized loans were properly reimbursed and resolved, as such; supporting documents must be submitted to HUD for consideration during the audit resolution process.
- Comment 17** Officials for the agent contend that partial reimbursement was made pertaining to the unauthorized withdrawals from the residual receipts fund, and that the owner will request HUD approval of the bills that were paid covering the balance. Our review did not disclose any evidence to support that unauthorized withdrawals were properly reimbursed and resolved.
- Comment 18** Officials for the agent state that there were two HUD 9839 Management Certification forms in circulation for each project leading to confusion regarding the excessive management fees paid. However, our review did not disclose evidence that the owner waived \$24,710 in uncollected management fees for Touraine Apartments. As such, during the audit resolution process HUD will determine whether these funds were properly reimbursed and resolved. Also, the owner did not address the ineligible employee advance that should be repaid.

- Comment 19** The actions taken are responsive to our recommendations, however documentation for the surcharge still needs to be submitted to HUD for an eligibility determination or the amount should be repaid.
- Comment 20** Officials plan to include complete documentation of the shared expenses in their supplemental allocation plan, which is responsive to our recommendation. Thus, any amounts not supported should be repaid.
- Comment 21** Officials for the agent provided a copy of the cancelled check and statement from Prudential as evidence that the \$91,650 payment for the mortgage-restructuring note was properly recorded. We have reviewed the documentation submitted subsequent to our review and conclude that although the documentation supports that the \$91,650 was paid, it does not provide evidence that the project has not been encumbered.

## Appendix C

### CRITERIA

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- A. HUD Handbook 4381.5, REV-2, CHG-2, “The Management Agent Handbook,” paragraph 6.50(a), provides that when an owner/agent is contracting for goods or services involving project income, an agent is expected to solicit written cost estimates from at least three contractors or suppliers for any contract, ongoing supply, or service which is expected to exceed \$10,000 per year.
- B. HUD Handbook 4381.5, REV-2, CHG-2, “The Management Agent Handbook,” paragraph 6.50(b), provides that for any contract, ongoing supply, or service estimated to cost less than \$5,000 per year, the agent should solicit verbal or written cost estimates to assure that the project is obtaining services, supplies, and purchases at the lowest possible cost. The agent should make a record of any verbal estimate obtained.
- C. HUD Handbook 4381.5, REV-2, CHG-2, “The Management Agent Handbook,” paragraph 6.50(c), provides that documentation of all bids should be retained as a part of the project records for three years following the completion of the work.
- D. HUD Handbook 4370.2, REV-1, CHG-1, “Financial Operations and Accounting Procedures for Insured Projects,” paragraph 2-6(e), provides that all disbursements from the regular operating account (including checks, wire transfers, and computer-generated disbursements) must be supported by approved invoices/bills or other supporting documentation.
- E. HUD regulatory agreement, paragraph 8(b), provides that the owner shall not, without the prior written approval of the HUD Secretary, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs.
- F. HUD regulatory agreement, paragraph 8(e), provides that the owner shall not, without the prior written approval of the HUD Secretary, make or receive and retain any distribution of assets or any income of any kind of the project except surplus cash.
- G. HUD regulatory agreement, paragraph 2(c), provides that the owner shall establish and maintain, in addition to the reserve fund for replacements, a residual receipts fund by depositing thereto the residual receipts within 60 days after the end of the semiannual or annual fiscal period within which such receipts are realized. Residual receipts shall be under the control of the HUD Secretary and shall be disbursed only on the direction of the Secretary, who shall have the power and authority to direct that

the residual receipts, or any part thereof, be used for such purpose as he may determine.

- H. HUD Handbook 4370.2, REV-1, CHG-1, "Financial Operations and Accounting Procedures for Insured Projects," paragraph 2-11(a), provides that advances made for reasonable and necessary operating expenses may be paid from surplus cash at the end of the annual or semiannual period.
- I. HUD Handbook 4370.2, REV-1, CHG-1, "Financial Operations and Accounting Procedures for Insured Projects," paragraph 2-11(b), provides that to encourage owners to make advances to projects in critical situations, HUD may approve on a case-by-case basis requests to make advances and for repayment of such advances on a monthly basis.
- J. Project Owner/Management Agent Certification for Cayuga Village, effective January 1, 2004, through December 31, 2009, and signed August 11, 2004, paragraph 1b(2), provides that the agent will collect from the project a management fee of 6.25 percent of residential income collected.
- K. Project Owner/Management Agent Certification for Touraine Apartments, effective January 1, 2004, through December 31, 2009, and signed August 11, 2004, paragraph 1b(2), provides that the agent will collect from the project a management fee of 6.25 percent of residential income collected.
- L. HUD mortgage restructuring regulatory agreement, paragraph 1, provides that the owners assume and agree to promptly make all payments due under the note and mortgage.