OFFICE OF AUDIT
REGION 4
ATLANTA, GA

McClain Barr and Associates, Summerfield, NC

Multifamily Housing Management Agent

AUDIT REPORT NUMBER 2013-AT-1002

MARCH 20, 2013

Issue Date: March 20, 2013

Audit Report Number: 2013-AT-1002

TO: Dottie R. Troxler, Director, Greensboro Multifamily Housing Hub, 4FHMLA

//signed//

FROM: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: McClain Barr and Associates, Summerfield, NC, Did Not Properly Charge Frontline Costs to Its Properties

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of McClain Barr and Associates.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.

March 20, 2013

McClain Barr and Associates, Summerfield, NC, Did Not Properly Charge Frontline Costs to Its Properties

Highlights

Audit Report 2013-AT-1002

What We Audited and Why

We audited McClain Barr and Associates (management agent) based on a request from the U.S. Department of Housing and Urban Development's (HUD) Greensboro, NC, Office of Multifamily Housing. The request expressed several concerns regarding McClain Barr's management of its HUD-assisted properties. Our objective was to determine whether HUD's concerns had merit and whether the frontline costs that the management agent charged its HUD properties complied with its regulatory and management agreements or other HUD requirements.

What We Recommend

We recommend that HUD's Greensboro Office of Multifamily Housing require that the management agent provide support that it properly charged its HUD properties more than $803,000 for frontline costs and repay more than $68,000 in ineligible frontline charges. We also recommend that HUD review the eligibility of the remaining 2012 frontline costs that occurred after our audit period and require the management agent to begin charging its HUD properties only actual eligible frontline expenses as outlined in the requirements.

What We Found

The management agent did not follow HUD's requirements for charging its properties frontline expenses. It failed to maintain documentation supporting the eligibility of its charges, made charges based on budgeted amounts, charged management agent staff costs to properties, and charged some ineligible items. This condition occurred because the agent disregarded both HUD's requirements and its management agreements with the property owners. As a result, the agent may have deprived the properties of more than $872,000, which could have been used for project operations, improvements, or other allowable expenditures.

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BACKGROUND AND OBJECTIVE

In 2002, Steve McClain and David Barr founded McClain Barr and Associates (management agent) to provide property owners with dedicated property management services focused on increasing property cashflow, improving resident satisfaction, and improving properties' physical condition.

The management agent managed 17 apartment communities – 14 in North Carolina and 3 in South Carolina. All but 2 had HUD-insured mortgages, and 12 had U.S. Department of Housing and Urban Development (HUD)-subsidized rents. The management agent principals owned four of the properties.

McClain Barr properties			
Property name	**Property type**	**Ownership interest**	**Units**
Alpha Arms	Section 221(d)(4) - HUD insured & subsidized	No	104
DeSoto Square	Section 202/223(f) - HUD insured & subsidized	No	32
Easley Housing	Section 221(d)(4)/223(f) - HUD insured & subsidized	No	40
Gee Corbett	Section 202/223(f) - HUD insured & subsidized	No	38
The Grand at Day Point	Section 221(d)(4) - HUD insured &subsidized	Yes	160
The Grand on Julian	Section 221(d)(4) - HUD insured only	Yes	240
The Grand in Kannapolis	Section 221(d)(4) - HUD insured only	Yes	240
Greenleaf Grace	Section 202 - HUD insured & subsidized	No	41
Lakeview Apartments	HUD subsidized only	No	40
Princeton Terrace	Section 221(d)(4)/223(a)(7) – HUD insured only	No	144
Puller Place	Section 221(d)(4)/223(f) - HUD insured only	Yes	240
Saint James Plaza	Section 202 - HUD insured & subsidized	No	40
Saint John Housing	Section 202 - HUD insured & subsidized	No	36
Sandy Run	Section 221(d)(3) - HUD insured & subsidized	No	152
Ujima Village	Section 202 - HUD insured & subsidized	No	36
Washington Terrace	Not HUD insured or subsidized	No	245
Williams DeLashmet	Section 811 - HUD insured & subsidized	No	25

Management agents that operate HUD-insured and HUD-assisted multifamily properties play a key role in helping HUD provide quality affordable housing.

Property owners contract with a management agent through a management agreement to oversee the day-to-day operations of the property and maintain the financial and accounting records. The management agent executes a management certification providing that it will comply with the property's regulatory agreement and other HUD requirements.

By signing the project owner's-management agent's certification, the agent agrees to, among other things,

- Ensure that all expenses of the project are reasonable and necessary;
- Exert reasonable effort to maximize project income and take advantage of discounts, rebates, and similar money-saving techniques; and
- Obtain contracts, materials, supplies, and services, including the preparation of the annual audit, on terms most advantageous to the project.

Our objective was to determine whether HUD's concerns had merit[1] and whether the frontline costs that the management agent charged its HUD properties complied with its regulatory and management agreements or other HUD requirements.

[1] See the Scope and Methodology Section for details of HUD's concerns.

RESULTS OF AUDIT

Finding: The Management Agent Did Not Follow HUD's Requirements for Frontline Costs

The management agent did not follow HUD's requirements for charging its properties frontline[2] expenses. It failed to maintain documentation supporting the eligibility of charges allocated to properties based on budgets, charged some management agent staff costs directly to properties, and charged some ineligible items. These conditions occurred because the agent disregarded both HUD's requirements and its management agreements with the property owners. As a result, the agent may have deprived the properties of more than $872,000, which could have been used for project operations, improvements, or other allowable expenditures.

The Agent Lacked Support for Charges Allocated to the Properties

The management agent's documentation did not support the $570,286 that it allocated to the properties through a monthly per unit fee based on budgeted amounts that represented allowable frontline expenses.[3]

In addition to the general management fees that the management agent charged the property owners under the terms of the management agreements, it charged most properties a monthly per unit fee comprised of several expenses paid by the management agent.[4] The fee included a portion of the salaries that the management agent's owners paid themselves, a portion of the salary for the management agent's office manager, phone and Internet charges, postage, office supplies, and copier expenses. The total charges for these items were divided by the number of units in the inventory to determine the per unit frontline charge. The agent charged most properties the same amount each month based on the number of units it contained.[5]

Although the types of charges that made up the monthly per unit fee were eligible frontline expense items, the management agent made the charges based on

[2] The Management Agent Handbook, HUD Handbook 4381.5, REV-2, paragraph 6.38(a)(1), defines eligible frontline expenses that management agents may charge HUD properties. Some examples include taking applications, screening tenants, and accounting for project income and expenses.
[3] See Appendix C for a breakdown of all questioned costs by property.
[4] The management agent did not charge one of the properties frontline fees because of the terms in its management agreement.
[5] All but two properties were charged the same monthly per unit fee. One property was not charged a fee (see footnote 4) whereas the other property was charged a reduced rate in accordance with its management agreement with the agent.

budgeted amounts. HUD's Management Agent Handbook stipulates that only actual costs directly attributable to the performance of frontline duties are eligible frontline expenses.[6] In addition, costs cannot be allocated to properties based on an arbitrary system such as the number of units; any proration of charges must be in proportion to each property's actual use.[7]

The management agent's use of budgeted amounts and arbitrary allocation also violated the properties' regulatory and management agreements. The regulatory agreements require that any payments from property funds be reasonably necessary for property operations and that any services or materials provided be delivered to the property.[8] The management agreements between the agent and the various property owners stated that the agent would be reimbursed actual expenses for centralized frontline accounting staff.[9]

<u>Owners Charged Their Salaries to the Properties</u>

The owners of the management company charged a portion of their salaries to the properties as frontline expense through the monthly per unit fee. Although some services provided by the owners, such as property accounting, were eligible frontline expense items, they were not properly charged. The charges were not actual expenses but budgeted amounts derived from salary costs that the owners had arbitrarily set for themselves instead of what the services would have cost in the marketplace.

The two owners served as chief executive officer and chief operating officer of the management company but also provided some frontline services to the properties. Although the percentages varied over time, during 2012, the chief executive officer charged 55 percent of his salary to the properties, and the chief operating officer charged 75 percent based on an $85 per hour rate that they derived from their total budgeted salary cost. The owners' timesheets did not specifically identify the frontline duties performed for each project or segregate time spent on management agent functions as required by HUD.[10] Their timesheets showed only general items such as recording rents, payroll, or month end accounting and did not show the specific projects for which the duties had been performed. In addition, their job descriptions did not conform to HUD's requirement that management agents develop a job description for each position outlining the frontline responsibilities separate from the nonfrontline

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[6] HUD Handbook 4381.5, REV-2, paragraph 6.38(a)(2)(a)(ii)

[7] HUD Handbook 4381.5, REV-2, paragraph 6.38(a)(2)(a) - The agent must prorate the total associated costs among the projects served in proportion to the actual use of services.

[8] Regulatory agreement, section 11(c)

[9] Management agreement, section 22(c) - The project will reimburse the agent monthly actual expenses for centralized frontline accounting staff. Frontline reimbursement will be reviewed and adjusted annually and is subject to HUD guidelines in Handbook 4381.5, REV-2.

[10] HUD Handbook 4381.5, REV-2, paragraph 6.38(b)(4), states that a management agent's generalist staff must document hours spent and duties performed on frontline activities for each project and those spent on the central office functions.

responsibilities.[11] Finally, the owners did not support that either the $85 per hour rate or the $525,356 that they charged to the properties for their salaries during the audit period was reasonable.

HUD requires that management agents perform an annual justification for the cost of providing frontline services directly rather than procuring them from an outside vendor.[12] The management agent did not perform a justification and analysis each year for the accounting services provided by the owners. Instead, during 2009, it performed an analysis based on a template from another management company and extended that analysis forward by applying a 5 percent annual inflation rate. That analysis assumed that the agent would need to hire five additional full-time staff members qualified in four disciplines to replace the owners' part-time frontline work. It used the 2009 Real Estate Compensation Survey to show that the total employment cost for the additional staff members would be prohibitive. However, the survey supported the reasonableness of the management agent's projected salary cost for only one of the five positions. In addition, the arbitrary 5 percent annual inflation rate used to increase the assumed salaries each year was not comparable to the actual inflation rates, which were considerably lower.[13] Finally, the analysis did not adequately explain why it would take five full-time staff members to perform the tasks that the owners performed part time.

The Agent Charged Its Office Manager's Salary to the Properties

The timesheets for the management agent's office manager, 24 percent of whose salary was allocated to the projects as frontline cost in 2011 and 30 percent in 2012 did not specify how he spent his time. The timesheets noted only that he was a salaried employee; they did not show hours or activities. The management agent allocated $8,260 of the office manager's budgeted salary to frontline cost in 2011 and $4,828 in 2012 as part of the monthly per unit fee.

The Agent Charged Excessive Office Expenses to the Properties

As part of the monthly per unit fee, the agent charged the properties $31,842 for office expenses during the audit period. Instead of charging each property for any actual office expense, as HUD requires, the agent's documentation showed that it charged the properties for all of its postage and copier expense based on a budgetary estimate. The agent allocated none of these costs to the operation of the management company.

[11] HUD Handbook 4381.5, REV-2, paragraph 6.38(b)(2)
[12] HUD Handbook 4381.5, REV-2, section 6.38, figure 6-2, 1st row
[13] According to the U.S. Department of Labor, Bureau of Labor Statistics, the consumer price index ranged from 1.5 percent to 3.0 percent, with an average of 2.4 percent between 2009-2011.

The Agent Charged Other Staff Salaries to the Properties

The management agent charged actual salary costs for three other staff members directly to the properties instead of as a part of the monthly per unit fee. The timesheets for these staff members did not support that they performed eligible frontline activities. Their timesheets specified only that they were salaried employees who worked 8 hours per day. During the 22 months of our audit period, the agent allocated $233,601 in salary costs for these employees to various properties using a percentage basis instead of actual time spent working for the properties.

The Agent Charged the Properties for Ineligible Items

The management agent charged its properties $68,570 in frontline expenses for ineligible communication services and car allowances.

Between July 2010 and April 2012, the management agent charged the properties $12,165 for phone lines and Internet service provided to the management agent. Phone lines and modems must be dedicated to automation equipment required by HUD to qualify as an eligible frontline expense.[14]

The management agent charged its properties at least $56,405 for the cost of car allowances for management agent employees. According to HUD's requirements, an agent's travel expenses to visit properties and meet with owners should be paid from the agent's general management fees.[15]

Conclusion

The management agent did not properly charge frontline expenses to its properties. It charged properties based on budgeted amounts, did not maintain adequate documentation for supporting its charges, and charged some ineligible items. This condition occurred because the management agent disregarded both HUD requirements and its management agreements with the properties' owners. As a result, the agent may have deprived the properties of more than $872,000 that could have been used for property operations, improvements, or other needs permissible under HUD's requirements.

[14] HUD Handbook 4381.5, REV-2, section 6.38, figure 6-2, 6th row
[15] HUD Handbook 4381.5, REV-2, section 6.38, figure 6-2, 5th row

Recommendations

We recommend that the Director of the Greensboro Office of Multifamily Housing

1A. Require the management agent to provide support that $570,286 that it charged the properties using a monthly per unit fee represented actual eligible frontline costs or repay each affected property from non-Federal funds.

1B Require the management agent to provide support that $233,601 in staff salaries that it directly charged the properties represented actual eligible frontline costs or repay each affected property from non-Federal funds.

1C. Require the management agent to repay each affected property its portion of the $68, 570 that it charged for ineligible items.

1D. Review the remaining 2012 frontline expenses charged to the properties after our audit period and require the management agent to repay each affected property any ineligible charges.

1E. Require the management agent to begin charging properties actual eligible frontline expenses as outlined in HUD's requirements.

SCOPE AND METHODOLOGY

The HUD Greensboro, NC, Office of Multifamily Housing requested that we review McClain Barr's management of its HUD-assisted properties. That request expressed both general and property-specific concerns regarding the agent's management of HUD-assisted properties. The overall concerns included frontline charges to the properties as well as low management scores for some properties. We began our review by looking at the agent's management of Williams DeLashmet Crossing since HUD expressed several specific concerns regarding that property. Some of those concerns included whether (1) the property manager worked full time and whether his salary increase was justified, (2) whether the property's board was providing sufficient oversight, and (3) whether some residents' claims that their utilities had been cut off for non-payment were valid.

A review of Williams DeLashmet Crossing confirmed that the property's board was providing little oversight; however, we were able to resolve most of HUD's other concerns with that property. We also found that the agent's accounting for cash receipts and the reserve for replacement account met HUD's requirements and the property appeared to be in satisfactory physical condition. However, we found some questionable frontline charges to the property and expanded our scope to include the frontline costs for all of the agent's properties.

We performed our onsite work from May 31 through September 17, 2012, at the management agent's administrative offices located at 6353 Poplar Forest Road, Summerfield, NC. We also conducted a site visit at the Williams DeLashmet Crossing property at 2102 Aileen Court, High Point, NC. The review generally covered the period July 2010 through April 2012 and was expanded as determined necessary.

To accomplish our objective,

- We reviewed the HUD Handbooks 4370.2, REV-1 (Financial Operations and Accounting Procedures for Insured Multifamily Projects); 4350.1 (Multifamily Asset Management Project Servicing); 4381.5 (Management Agent Handbook); and HUD-9839-B (Project Owner's and Management Agent's Certification for Multifamily Housing Projects for Identity-of-Interest of Independent Management Agents).

- We reviewed the management agent's accounting records; audited financial statements for 2010 and 2011; the management agent's general ledgers and bank statements; Real Estate Assessment Center property inspection reports; HUD management reviews; cash receipts and disbursements; invoices; and employee listings.

- We interviewed the management agent chief executive officer, chief operating officer, and employees and the HUD Greensboro Office of Multifamily Housing staff members involved with oversight of the management agent's properties.

For the Williams DeLashmet Crossing property,

- We reviewed the regulatory agreement between HUD and the property's owner; the property's general ledgers, bank statements, and tenant listings; and the audited financial statements for 2010 and 2011.

- We interviewed the board chairwoman, management agent chief executive officer, chief operating officer, and employees and the HUD Greensboro Office of Multifamily Housing staff members involved with oversight of the management agent's properties.

- We selected several nonstatistical samples as described below. The results from these samples apply only to the sampled items and were not projected to the universe as a whole.

    - We reviewed a random sample of the property's cash disbursements for 5 of the 22 (23 percent) months in our review scope to determine whether the disbursements were reasonable and necessary for the operations of the property.

    - We reviewed a random sample of the property's cash receipts for 5 of the 22 (23 percent) months in our review scope to determine whether the receipts were supported and properly accounted for.

    - We reviewed a random sample of 4 of the 7 (57 percent) reserve for replacement disbursements to determine whether the funds were used as authorized by HUD.

We expanded our review to include the agent's calculation of total frontline expenses that it used to determine the frontline costs charged to all fifteen of its properties. We also reviewed other frontline activities and car allowances that were charged directly to the properties. No additional samples were taken.

We tested electronic data relied upon during the performance of the various review steps. We conducted tests and procedures to ensure the integrity of computer-processed data that were relevant to our audit objective. The tests included, but were not limited to, comparisons of computer-processed data to invoices and other supporting documentation. We found the data to be generally reliable.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Compliance with applicable laws and regulations – Policies and procedures to ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The management agent failed to comply with HUD's requirements for frontline costs (see finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A		$570,286
1B		233,601
1C	$68,570	
Total	$68,570	$803,887

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 policies 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 the 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

McClain Barr & Associates
An Apartment Management Company

February 5, 2013

Ms. Nikita Irons
Regional Inspector General for Audit
Office of Audit (Region 4)
75 Spring Street, SW
Box 42
Room 330
Atlanta, GA 30303

Dear Ms. Irons:

Thank you for the opportunity to respond to the draft audit ("Draft"). We believe the Inspector General (OIG) auditors have not correctly interpreted the data provided. We look forward to reviewing the final audit with the field office.

We request that OIG modify the Draft to note that McClain Barr and Associates ("MBA") did in fact properly charge front line expenses, charge expenses reasonable in amount and directly related to front line activities, and does not owe or have questioned costs in the amount of $872,000.

Please note that MBA and its principals take this matter very seriously, as each has a
longstanding commitment to proper property management. We correspond regularly with the
officials in our local HUD office, and received a "superior" rating in our most recent
Comment 1 management review. This management review included an in-depth examination by our local
HUD office of our front-line charges that we have billed to the properties on a per-unit per-
month basis. In addition to the review by the local HUD office, we have had our front-line
Comment 2 charges reviewed over the years by 3 different 3rd party auditing firms and our processes and
procedures were determined to be in compliance with HUD regulations.

As a general matter, charging frontline reimbursements is to offset the time and expense
MBA staff incur to provide centralized accounting and computer services to each property. We
Comment 3 believe that MBA's practices are economical and cost competitive. Furthermore, we did not
even charge all of the costs we verified it took to provide these services. We believe our
documentation is adequate and supports the amounts we have charged. Furthermore, we believe
all amounts we have charged for front-line expenses fall specifically within the category of
allowable costs paid from Project funds, as delineated in figure 6-2 of section 6.38 of chapter 6
Comment 4 of HUD's Management Agent Handbook (4381.5 REV-2).

Office 336.644.1262 • Fax 336-643-2061 • www.mcclainbarr.com
6353 Poplar Forest Drive • Summerfield, NC 27358

Ms. Nikita Irons
February 5, 2013
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Comment 5

The OIG recommends that we provide support for more than $803,000 of front-line and salary costs that were charged to the Projects. We have provided and are once again providing extensive documentation which supports the calculation and business purpose of the amounts charged. The support we provided for our frontline reimbursements was far more extensive than the documentation we provided the local HUD office in their most recent management review of MBA. Our position has been and remains that we have adequately supported these costs.

Comment 3

Comment 6

Comment 7

Comment 8

Comment 3

We submit that reasonable expenses incurred for front-line management activities may be charged to the project operating account. HUD Handbook 4381.5 REV-2, section- 6.38(a)(1). Handbook 4381.5 also provides that "all costs related to maintaining a centralized or project-based accounting functions of the project" may be reimbursed from Project funds, provided that "each year, the agent must determine that these costs are at or below the market and maintain such evidence on-site." Figure 6-2. Included in these charges are "prorated costs on a per-unit basis for centralized accounting systems;" "Travel expenses incurred by front-line staff" are reimbursable from Project funds. It is appropriate to develop "a reasonable hourly rate, which will be used to bill individual projects for time spent on front-line functions." Section 6.38(b)(3). Further, "The cost of supervisory personnel providing oversight of centralized accounting and computer services for a project may be paid out of project funds." Section 6.39(c)(1). To that end, "A prorated share of the salaries for such supervisors may be charged to the project's account." Section 6.39(c)(1)(a). These charges "may not exceed the cost of procuring comparable services from an independent contractor" Section 6.39(c)(1)(b)

Comment 9

The OIG recommends that we repay more than $68,000 of ineligible items to the Projects. The OIG's determination was based incorrectly on our overall computation, which included $12,165 of costs for phone and internet lines that the OIG has determined were ineligible. However, the OIG did not consider the amounts we actually charged to the Projects in making this determination, which was significantly less than our overall actual per unit charge.

Comment 10

Moreover, this will be the third time that HUD has analyzed such issues, but the first time that a HUD office has questioned the costs. HUD issued a July 7, 2004 Team Management Review with a Satisfactory Rating. That report found that there was "no problem" with management fee collection practices, and specifically, the "analysis submitted is acceptable as to the costs being allocated to the front-line." MBA has used the same practices since that time. The second time, in HUD's June 13, 2008 Team Management Review **(Superior Rating)** had no serious findings in financial management. The Draft now contradicts the findings of the program office reviewing the same information. We submit that the program office correctly interpreted its own guidance, repeatedly, and the Draft did not accurately reflect the facts or guidance.

Comment 11

We remain committed to our mission of providing superior property management services in compliance with all applicable laws, regulations and rules. We respectfully request the Draft be corrected so as to state that the OIG found no violations of or noncompliance with HUD regulations relating to payment of front-line costs.

Sincerely,

B. Stephen McClain
CEO, McClain Barr & Associates, LLC

David W. Barr
COO, McClain Barr & Associates, LLC

OIG Evaluation of Auditee Comments

Comment 1 The most recent management review conducted by the local field office was completed during 2008 while our review period began with July 2010. HUD's management reviews are often more broad than in-depth because they need to cover multiple areas of management agent operations in a short amount of time. The frontline charges portion of the 2008 management review consisted of only one three-part question on a standardized checklist. HUD completed the entire management review in only two days. Our in-depth review concluded that the management agent did not follow HUD's requirements for charging the properties frontline expenses and failed to maintain supporting documentation. See also, Comment 10.

Comment 2 We agree that many of the types of charges made by the management agent are allowable. However, we disagree with the reasonableness of the amounts charged to the individual properties. We are unable to comment regarding the work of any 3rd party auditing firms since we do not have information regarding the scope of their reviews and have not reviewed their work.

Comment 3 The management agent's justification and analysis for providing frontline services directly, rather than procuring them from an outside vendor, did not adequately support the charges. The management agent provided no explanation as to why it would take five additional full-time staff members to perform the tasks that the owners performed part time.

Comment 4 While we agree that most of the types of frontline charges made by the management agent fall within the types of charges the handbook cites as being allowable, we do not agree with the agent's methodology for computing the charges or the total amounts charged to the HUD properties for frontline expenses.

Comment 5 We reviewed approximately a thousand pages of documentation the management agent provided in response to the draft report. We had already reviewed most of the documentation during our on-site work, and, in our opinion, the material was not sufficient to establish eligibility for the questioned costs in the draft report. We will provide the documents to the Greensboro Multifamily Hub for consideration during the management decision process.

Comment 6 HUD Handbook 4381.5 REV-2, Figure 6-2 states that eligible travel expenses incurred by frontline staff include making bank deposits, meeting with contractors, and attending training. The handbook specifically states that the management agent's travel expenses to visit the project are costs that should be paid from the management fee.

Comment 7 HUD Handbook 4381.5 REV-2, Section 6.38(b)(3) further states that a ***reasonable*** hourly rate includes the hourly salary for the position and an allocation for overhead expenses, and should not exceed the amount that would be paid to ***an on-site staff with similar experience*** [emphasis added]. The management agent has not supported that the $85 per hour salary rate was reasonable, i.e., that it did not exceed an amount that would be paid to someone with the appropriate bookkeeping and accounting experience.

Comment 8 The management agent is correct in stating that handbook 4381.5 REV-2 Section 6.39(c)(1)(a) allows prorated charges for supervisory personnel providing oversight of centralized accounting and computer services for a project. However, the management agent has not provided acceptable support for the reasonableness of the charges made to the projects in accordance with Section 6.39 (c)(1)(b).

Comment 9 Although the actual per unit charge was less than what the management agent claimed it could have charged with the phone and Internet included, we still consider the per unit charges ineligible. The phone and internet charges are ineligible and should be returned to each affected property.

Comment 10 HUD requested our office conduct a more in-depth review of the management agent's supervision of its HUD assisted properties. That request expressed concern regarding whether the management agent's charges were reasonable and necessary as required by HUD. The conclusions in this report are based solely on our audit work including our interpretation of the applicable HUD requirements; they are not dependent on any prior HUD or independent auditor reviews.

Comment 11 We thank the management agent for responding to the draft report and providing the additional documentation for our consideration. Based on our review of the documents, we did not find that it was necessary to revise the report.

Appendix C

BREAKDOWN OF QUESTIONED COSTS BY PROPERTIES

	Unsupported costs		Ineligible costs		
Property name	Charges based on budgets	Charges directly to properties	Car allowance	Phone and internet	Totals
Alpha Arms	$ 40,163	$ 20,616	$ 5,213	$ 857	$ 66,848
DeSoto Square	$ 12,164	$ 11,700	$ 4,367	$ 259	$ 28,490
Easley Housing	$ 15,205	$ 13,041	$ 4,553	$ 324	$ 33,124
Gee Corbett	$ 14,870	$ 23,942	$ 5,570	$ 317	$ 44,699
The Grand at Day Point	$ 60,774	$ 22,253	$ 4,396	$ 1,296	$ 88,720
The Grand on Julian	$ 75,473	$ -	$ -	$ 1,610	$ 77,083
The Grand in Kannapolis	$ 95,485	$ -	$ -	$ 2,037	$ 97,522
Greenleaf Grace	$ 15,585	$ -	$ -	$ 332	$ 15,918
Lakeview Apartments	$ 15,205	$ 12,986	$ 4,540	$ 324	$ 33,056
Princeton Terrace	$ 22,453	$ -	$ -	$ 479	$ 22,932
Puller Place	$ 91,232	$ -	$ -	$ 1,946	$ 93,178
Saint James Plaza	$ 14,779	$ 23,947	$ 5,573	$ 315	$ 44,614
Saint John Housing	$ 13,685	$ 23,202	$ 5,491	$ 292	$ 42,670
Sandy Run	$ 58,700	$ 52,648	$ 8,732	$ 1,252	$ 121,332
Ujima Village	$ 14,858	$ 12,986	$ 4,540	$ 317	$ 32,702
Washington Terrace	$ -	$ -	$ -	$ -	$ -
Williams DeLashmet	$ 9,655	$ 16,280	$ 3,430	$ 206	$ 29,570
	$ 570,286	$ 233,601	$ 56,405	$ 12,165	$ 872,457