Stone Terrace Apartments
Chicago, IL

Section 8 Housing Assistance Payments Program

Office of Audit, Region 5
Chicago, IL

Audit Report Number: 2017-CH-1005
August 25, 2017

To: Daniel J. Burke, Director of Multifamily Midwest Region, 5AHMLA

//signed//

From: Kelly Anderson, Regional Inspector General for Audit, Chicago Region, 5AGA

Subject: Stone Terrace Apartments, Chicago, IL, Did Not Always Comply With HUD's Requirements Regarding the Administration of Its Section 8 Housing Assistance Payments Program

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Stone Terrace Apartments' Section 8 housing assistance payments program.

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 8M, requires that OIG post its publicly available reports on the OIG website. 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 (312) 353-7832.

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Stone Terrace Apartments, Chicago, IL, Did Not Always Comply With HUD's Requirements Regarding the Administration of Its Section 8 Housing Assistance Payments Program

Highlights

What We Audited and Why

We audited the Stone Terrace Apartments' Section 8 housing assistance payments program based on a citizen's complaint alleging mismanagement of its housing assistance payments contract. The audit was part of the activities in our fiscal year 2017 annual audit plan. Our audit objective was to determine whether the management agent administered the project's program in accordance with the owner's contract with the U.S. Department of Housing and Urban Development's (HUD) and its own requirements.

What We Found

Stone Terrace Apartments' management agent, East Lake Management Group, Inc., did not always administer the project's program in accordance with HUD's and its own requirements. Specifically, it did not always correctly calculate and support housing assistance payments for the program households and properly administer the project's waiting lists. As a result, the project inappropriately received more than $85,000 in ineligible and more than $6,000 in unsupported housing assistance. If the management agent does not correct its tenant certification process, HUD could overpay the project more than $76,000 in housing assistance over the next year. In addition, housing assistance may have been unjustly denied or delayed for eligible applicants on the project's waiting lists.

What We Recommend

We recommend that the Director of HUD's Chicago Office of Multifamily Housing Programs require the project owner to (1) reimburse HUD from non-project funds for the ineligible housing assistance payments, (2) reimburse the appropriate households for the underpaid housing assistance, (3) reimburse HUD for the overpayment of housing assistance due to unreported income, (4) support or reimburse HUD from non-project funds for the unsupported housing assistance payments, (5) update the waiting lists to include applicable notations, and (6) implement adequate policies, procedures, and controls to address the issues cited in this audit report.

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Background and Objective

Stone Terrace Partners, Limited Partnership, is the owner of Stone Terrace Apartments, a 156-unit multifamily property in Chicago, IL. The partnership was formed under the laws of the State of Illinois on April 1, 2001, for the purposes of renovating and operating the 156 units under section 221(d)(4) of the National Housing Act. Since such projects are regulated by the U.S. Department of Housing and Urban Development (HUD) regarding rent and operating methods, all families are eligible to occupy dwellings in a structure whose mortgage is insured under this program, subject to normal tenant selection. The partnership has one general partner, Stone Terrace Management Company, LLC, which has a 0.01 percent interest, and one limited partner, Chicago Equity Fund 2000, Limited Partnership, which has a 99.99 percent interest. The partnership entered into a management agreement with an affiliate of the general partner, East Lake Management Group, Incorporated.

National Housing Compliance, HUD's contract administrator for the project, renewed the project-based Section 8 housing assistance payments contract with the owner of the project under section 524(a) of the Multifamily Assisted Housing Reform and Affordability Act of 1997, effective October 10, 2013. HUD made housing assistance payments for the project under a Section 8 housing assistance payments contract, which covered 154 of the 156 units. During our audit period, November 2014 through October 2016, HUD provided the partnership more than $3.1 million in housing assistance.

The project-based housing assistance payments program provides rental assistance to low-income individuals and families, enabling them to live in affordable, decent, safe, and sanitary housing. HUD makes the assistance payment to the owner of an assisted unit on behalf of an eligible family, defined as having income at or below 80 percent of the area median income adjusted for family size. The family pays the higher of (1) 30 percent of its monthly adjusted income, (2) 10 percent of its monthly income, (3) welfare rent (if applicable), or (4) $25 minimum rent. The project owner is responsible for reexamining the family's income and composition at least once each year and adjusting the amount of assistance payments accordingly. However, the owner delegated those responsibilities to the management agent. As part of the tenant certification process, the management agent calculates the amount of the assistance payment, which is the difference between the contract rent and the family's share of the rent.

The objective of our audit was to determine whether the project's management agent administered the project's program in accordance with the owner's contract with HUD and its own requirements. Specifically, we wanted to determine whether the project's management agent correctly calculated and paid housing assistance and administered the project's waiting lists in accordance with HUD's and its own requirements.

Results of Audit

Finding: The Management Agent Did Not Always Administer the Project's Program in Accordance With HUD's and Its Own Requirements

The management agent did not always administer the project's program in accordance with HUD's and its own requirements. Specifically, it did not always correctly calculate and support housing assistance payments for the program households and properly administer the project's waiting lists. The weaknesses occurred because the owner and management agent did not implement adequate controls over the project's housing assistance payments program. As a result, the project inappropriately received more than $85,000 in ineligible and more than $6,000 in unsupported housing assistance. If the management agent does not correct its tenant certification process, HUD could overpay the project more than $76,000 in housing assistance over the next year. In addition, housing assistance may have been unjustly denied or delayed for eligible applicants on the project's waiting lists.

Miscalculated and Unsupported Housing Assistance Payments

We reviewed 133 certifications[1] to determine whether the management agent correctly calculated housing assistance payments for the period November 2014 through October 2016. Our review was limited to the information maintained by the management agent in its household files.

For the 133 certifications, 55 (41 percent) had incorrectly calculated housing assistance. The 55 certifications contained 1 or more of the following calculation errors:

- 32 had incorrect contract rents and utility allowances,[2]
- 25 had incorrect income, and
- 10 had unsupported deductions from income.

For the households associated with the 55 certifications, HUD overpaid $52,932 and underpaid $566 in housing assistance.

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[1] Our methodology for the selection of the 133 certifications representing 69 households is explained in the Scope and Methodology section of this audit report.
[2] The incorrect contract rents and utility allowances for 32 certifications were due to the household being overhoused.

Further, 11 of the 69 household files contained documentation showing that the households had valid unreported income, underreported income, or income reported late. However, the management agent failed to make adjustments to their housing assistance payments and execute repayment agreements with the households to recapture $32,334 in overpaid subsidies. In addition, HUD paid $6,444 in unsupported housing assistance.

The Management Agent Did Not Ensure That It Properly Administered the Project's Waiting Lists

We reviewed all 26 applicants from the project's internal transfer waiting list. Of the 26 applicants, 4 (15 percent) did not take priority over the households that had been admitted to the program from the project's external waiting list as required by the project's tenant selection plan. In addition, for five applicants that had been housed, the project's internal transfer waiting list did not contain move-in dates.

Of the 880 applicants on the project's external waiting list, 86 had been bypassed. Of the 86 applicants that had been bypassed, the project's external waiting list did not contain a notation to explain why 22 of the 86 applicants had not been admitted into the program as required by HUD.

The Project Had Inadequate Controls

The above deficiencies occurred because the owner and management agent did not implement adequate controls over the project's housing assistance payments program. Specifically, the owner and management agent lacked adequate oversight to prevent the management agent's staff from disregarding HUD requirements and to ensure that policies and procedures were updated. In addition, neither provided documented evidence that a quality control process had been implemented.

The management agent disregarded HUD's requirements. The households associated with the 32 certifications had incorrect contract rents and utility allowances due to being overhoused. The project's occupancy standards did not address the size and number of bedrooms needed based on the number of members of a household as required by HUD. The plan included only a not-to-exceed guideline. Further, although the project's occupancy standards were missing a key component, the management agent's president stated that the management agent was aware of HUD's occupancy requirements. However, its staff did not always transfer a household to the appropriate size unit due to the costs associated with preparing two units for occupancy instead of one. As a result of our audit, the management agent created a new unit transfer list for the households that were over- or under-housed.

The owner and management agent lacked adequate oversight of the program, including documented evidence of a quality control process. The president stated that the certifications that had incorrect income calculations and unsupported deductions were the result of errors made by the current and former property managers and not a systematic issue. The president also stated that there was a period when the current property manager was handling all recertifications in addition to many other responsibilities. She believed that the additional responsibilities of the property manager may have contributed to a few errors. Further, according to the president, the project's household files were subjected to quality control reviews. However, neither the president nor a staff person for the management agent provided documentation showing the project's quality control process or the files that had been reviewed.

The owner and management agent also did not have adequate policies and procedures. The project's tenant selection plan was missing the requirement to notate on its waiting list changes, actions taken, or activities specific to a particular applicant that had occurred as required by HUD. In addition, the management agent did not implement adequate procedures for ensuring compliance with HUD's requirements. The property supervisor stated that she had forgotten to update the project's internal transfer waiting list to include the dates on which the five applicants moved into their new housing units and notate on the external waiting list the reason why applicants had not been admitted to the project's program. Further, according to the property supervisor, 20 of the 22 applicants that did not have a notation on the external waiting list had been bypassed because they were unresponsive. The remaining two applicants either had not qualified or were no longer interested. The project supervisor was unable to provide documentation supporting that the 20 bypassed applicants were unresponsive because she did not maintain those records.

Conclusion

The owner and management agent did not implement adequate controls over the project's housing assistance payments program. Specifically, the owner and management agent lacked adequate oversight to prevent the management agent's staff from disregarding HUD requirements and to ensure that policies and procedures were updated. As a result, HUD overpaid $52,932 and underpaid $566 in housing assistance because the management agent incorrectly calculated rental housing assistance. Further, HUD overpaid $32,334 in housing assistance for 11 households that had unreported income, underreported income, or income reported late, and the management agent did not recapture the related overpaid housing assistance funds. The management agent also lacked support for housing assistance payments totaling $6,444 due to unsupported housing assistance calculations.

If the management agent does not correct its certification process, we estimate that HUD could overpay the project $76,107 in housing assistance over the next year. These funds could be put to better use if proper procedures and controls are put into place to ensure the accuracy of housing assistance payments.

In addition, housing assistance may have been unjustly denied or delayed for eligible applicants on the project's waiting lists.

Recommendations

We recommend that the Director of HUD's Chicago Office of Multifamily Housing Programs require the project's owner to

1A. Reimburse HUD $52,932 from non-project funds for the overpayment of housing assistance and utility allowances due to incorrect calculations.

1B. Reimburse the appropriate households $566 from non-project funds for the underpayment of housing assistance due to incorrect calculations.

1C. Reimburse HUD $32,334 for the overpayment of housing assistance due to unreported, and underreported income, or income reported late. This reimbursement is either from non-project funds or collections from applicable households.

1D. Support or reimburse HUD $6,444 from non-project funds for the unsupported payments of housing assistance cited in the finding.

1E. Implement adequate quality control procedures to ensure that housing assistance payments are appropriately calculated and supported. These procedures and controls should ensure that $76,107 in program funds are appropriately used for future payments.

1F. Document the implementation of the quality control plan and the completed reviews of the tenant certification process.

1G. Revise its occupancy standards to include policies and procedures to prevent underuse of the project's units.

1H. Review and update the project's internal transfer waiting list to include the applicants' move-in dates, and the project's external waiting list to include notations showing the reasons why applicants were not admitted into the project's program and why applicants were bypassed.

1I. Develop and implement adequate procedures and controls to ensure that the project complies with HUD's requirements and its own policies regarding the management of its waiting list.

Scope and Methodology

We performed our onsite audit work between November 2016 and April 2017 at the management agent's main office located at 2850 South Michigan Avenue, Chicago, IL. The audit covered the period November 1, 2014, through October 31, 2016, but was expanded as necessary.

To accomplish our audit objective, we interviewed HUD program staff, HUD's contract administrator's employees, and the management agent's employees. In addition, we obtained and reviewed the following:

- Applicable laws, HUD's regulations at 24 CFR (Code of Federal Regulations) Parts 5 and 886, and HUD Handbook 4350.3, REV-1.

- The project's regulatory agreement, housing assistance payments contract, management agreement, tenant selection plan, annual audited financial statements for fiscal years 2013 through 2015, bank statements, waiting lists, organizational chart, contract rents, housing assistance payments receipt register, and household and applicant files.

During our survey, we selected a random sample of 20 of the 180 households that received housing assistance from November 1, 2014, through October 31, 2016. Of the 20 households selected, we reviewed the first 10 (64 certifications) and determined that there were enough calculation errors to move forward into the audit phase. The results of the survey reviews were included in the total errors; however, they were not included in our projection to the universe.

During the audit, the sample was designed as a stratified random sample from a universe of 3,493 monthly housing assistance payments totaling nearly $3 million. A sample size of 73[3] was recommended for the audit. Based on the review results, average dollar amounts were estimated and projected to the universe as a whole. Applied to the universe of 3,493 housing assistance payments, we can say with a one-sided confidence of 95 percent that HUD overpaid at least $152,214 during the sample period. Applying our 24-month sample period to a typical 1-year period, we can say that these findings represent $76,107 per year in funds that could be put to better use by properly administering the program.

Although we selected 135 certifications (64 + 71), we reviewed 133 certifications because 2 of the certificates were duplicates. The 133 certifications represented 69 households.[4]

There were 26 households on the project's internal transfer waiting list as of November 2016. We reviewed the 26 households to determine whether the households had been given priority

[3] The 73 monthly housing assistance payments were from 71 certifications, which represented 61 households.
[4] The 69 households represent the 10 households selected during the survey plus 61 selected during the audit minus the 2 duplicates.

over the households from the project's external waiting list. We used the 100 percent selection sample method for our review of the project's in-house transfer waiting list. We selected this method because the universe was small enough for us to review all households on the list. Therefore, our results did not include a projection.

Data, Review Results, and Generally Accepted Government Auditing Standards

We relied in part on data maintained by the management agent in its systems. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes.

We provided our review results and supporting schedules to the Director of HUD's Chicago Office of Multifamily Housing Programs and the management agent's president during the audit.

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:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – 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 applicable laws and regulations – Policies and procedures that management has implemented to reasonably 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 owner and management agent did not implement adequate controls over the project's housing assistance payments program (finding).

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/
1A	$52,932		
1B			$566
1C	32,334		
1D		$6,444	
1E			76,107
Total	**85,266**	**6,444**	**76,673**

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.

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. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the project owner implements our recommendations, it will stop incurring program costs for the overpayment and underpayment of housing assistance and, instead, will spend those funds in accordance with HUD's requirements. Once the management agent improves its controls, this will be a recurring benefit. Our estimate reflects only the initial year of this benefit.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

EASTLAKE

MANAGEMENT GROUP, INC.

July 24, 2017

Kelly Anderson
Regional Inspector General for Audit, Region 5
U.S. Department of Housing and Urban Development – Inspector General
77 West Jackson Boulevard, Room 2201
Chicago, IL 60604

Dear Ms. Anderson:

East Lake Management Group, Inc. (East Lake) is in receipt of your draft audit concerning Stone Terrace Apartments' Section 8 Program. The following serves as East Lake's response to your findings and recommendations. Our overall response is that East Lake and ownership consider adherence to HUD's rules and regulations critical to our mission. We have instituted numerous systems and layers of control to maximize compliance with these rules. Working with HUD and its contractor NHC, we have continuously upleveled our systems to align with HUD's expectations. As evidence of our commitment, we participated in over 15 MORs in 2016 and received at least Satisfactory across the board.

The audit identifies a few areas where a combination of human error and inconsistency with internal transfers of over-housed families led to some deviation from strict compliance. However, the issues are easily addressed and, in our view, do not indicate a major systemic deficit on East Lake's part.

Rather than address each point individually, the purpose of this response is to provide context for some of the findings and to address some of the ways that these findings were characterized.

Comment 1

Over-housed Individuals: The Auditor characterizes payments for units in which tenants were over-housed as "incorrect contract rents." We respectfully disagree with this characterization. It is true that there were units in which tenants were over-housed. It should be noted, however, that they were properly sized upon move in and their over-housed status only occurred later because members of their households moved out. Most importantly, it also should be noted that the contract rents and utility allowances for each size of unit were appropriate and approved by HUD. East Lake never charged HUD more for any unit than was approved on the HAP contract. We do not agree that "over-housing" and "incorrect contract rents" are equivalent.

Comment 2

Following very early conversations with the Auditor, East Lake moved immediately to create the internal transfer list. To date, we have moved all but two of the over-housed households into appropriate units; the remaining two will be moved when the correct sized unit has been vacated by an existing household. We will continue to maintain an internal wait list and exercise diligence in downsizing households when their family composition changes.

Comment 3

The Auditor states that the "occupancy standards did not address the size and number of bedrooms needed based on the number of members as required by HUD." Our approved Tenant Selection Plan in fact does include the occupancy standard that correlates household size ranges to unit sizes. We believe that a "not-to-exceed guideline" – i.e., a range for each unit size – is consistent with HUD's requirements. In fact, our TSPs have been reviewed extensively by HUD, NHC and IHDA and found to be in compliance and missing no key components.

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Comment 4

East Lake agrees that we were not uniformly downsizing households that were over-housed and this issue has been addressed. However, neither East Lake nor the owner benefited financially from this situation. Because East Lake charged the correct amount for each bedroom size, we do not feel that a cash penalty is the appropriate remedy.

Unreported Income: Another category of concern was unreported income, i.e. tenants that had not reported income and their rent was too low. These issues fall into two sub-categories: actual recoupments and timing issues.

Comment 5

Actual Recoupments
We concur that there were four individuals that had unreported income that staff should have researched based on the EIV report. We are currently negotiating recoupment agreements with these individuals for a total of $16,000.00. The Auditor calls out a different amount but he is basing his calculation on the EIV report and not on verified income as required.

Comment 6

Timing Issues
There are several cases that the Auditor characterized as "unreported income" that we consider issues related to timing and not a failure to charge appropriate rents. In those cases, tenants did not consistently report increased income within 30 days and/or had difficulty providing all of the required paperwork to document the income increase and justify the rent increase. In these cases there was 30-60 days' worth of timing slippage due to (1) the delayed reporting, (2) issues with gathering documentation, and/or (3) providing 30 days' notice before a rent increase.

Comment 7

While ideally this process would only take 60 days, sometimes it takes longer due to the logistics involved. In our view, this is not a failure to adhere to HUD regulations but an occasional consequence of complying with competing requirements.

Comment 8
Comment 7

In the case of the actual recoupments, we are pursuing these funds aggressively and should not be required to pay a cash penalty. In the case of the much smaller underpayments due to timing issues, we do not feel that a cash payment is warranted because we were following HUD's protocols.

Errors: The Auditor did identify $18,000.00 in miscalculations. These miscalculations fell into two categories:

(1) There are several cases in which staff made errors about the frequency of paychecks (24 vs 26 per annum). While this is part of every staff person's training, it was this individual's error. Because it is not incorrect across the board, it's clear that the staff person knew the requirement and made a mistake. This will continue to be an aspect of our training.

(2) There were also several cases of what the auditor calls "unsupported deductions." One of these was a failure to terminate the college student deduction; the other three were based on inadequate evidence of child care. Again, these were human errors by staff that knew better.

Comment 9

East Lake acknowledges these calculation errors. However, the errors are not attributable to "inadequate quality control and training." While we provide extensive training and oversight for our staff; we cannot, however, eliminate all human error.

Comment 10

The actual calculation mistakes that were made are easy to identify and easy to understand. If one estimates that 69 files represents approximately $2.5 million in billing for three years, then $18,000.00 represents an error rate of less than 1%.

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In his letter, the Auditor questions our quality control protocols. As we discussed with the Auditor, we have a multilayered quality control process. The Auditor was provided with our training manual, our Common Mistakes manual and our sample file. The Auditor was told that each recertification specialist receives training and COS certification from a third party vendor. The Auditor interviewed the Quality Control Auditor/Trainer and was told what that individual's responsibilities are. The Auditor was told that there are at least two internal training sessions per year and frequent team conference calls. And he was told that East Lake's QC auditor reviews files on a regular basis. The HUD Auditor asked for a written file review document for Stone Terrace. Frequently East Lake's auditor reviews files and provides verbal direction to staff and does not always produce a written report. East Lake has a very robust quality control process in place and a commitment to training and re-training the staff.

Comment 10

Projected Overpayment: The summary indicates that the property inappropriately received $85,000.00 in ineligible housing assistance and that this could yield a projected future overpayment of $76,000.00. The IG reviewed three years' worth of data; the total of their findings for three years would not correlate to a comparable dollar amount in only one year.

Recommendations

Comments 2, 3, and 4

1A Of the $52,000.00 recommended for repayment, $43,000.00 is attributable to the tenants that were over-housed. East Lake did not financially benefit from this situation. We have moved most of the affected households. We do not agree that repayment is an appropriate remedy.

Comment 11

1B We will issue these tenants rent credits.

Comments 5, 7, and 8

1C We are currently pursuing the recoupments of $16,000.00; the proper balances based on verifications. The balance attributable to relatively short timing issues is a function of the process and should not require a cash repayment.

Comment 11

1D. We acknowledge that some deductions were inadequately documented.

Comment 12

1E We will continue to implement robust quality control training and auditing to continually improve the accuracy of our calculations.

Comment 12

1F We have documented the quality control procedures for the auditor and in this correspondence.

Comment 2

1G As noted, staff has established and will maintain an internal wait list for households that are under or over housed and require internal transfers.

Comment 13

1H The internal wait list format now includes these notations.

Comment 14

1I East Lake is committed to 100% compliance with HUD's required procedures. Our quality control plan reflects that commitment. We will use the results of this audit to continue to improve the capacity of our staff and the accuracy of our calculations.

Ref to OIG Evaluation

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We appreciate the insights provided by the IG in our efforts to continually review and improve our policies and procedures. Those issues identified by the Auditor have already been addressed and we will continue to be diligent in pursuing compliance.

Thank you for offering East Lake the opportunity to respond to the draft audit. Should you have any additional questions, please feel free to contact me at 312.949.3165.

Sincerely,

Eileen Rhodes
President

OIG Evaluation of Auditee Comments

Comment 1 East Lake contends that it should be noted in the report that the overhoused households were properly housed upon move-in. It also disagreed that characterizing overhousing as incorrect contract rents was not accurate. East Lake did not provide documentation to support its assertion regarding the households being properly housed when they moved in and this was out of our scope of work. In addition, the audit report accurately states that the households associated with the 32 certifications had incorrect contract rents and utility allowances due to being overhoused. Therefore, no changes were made to the report. However, East Lake should provide the indicated documentation to HUD for consideration in the audit resolution process.

Comment 2 East Lake contends that it created an internal transfer list (internal wait list for households that are under or over housed) and moved all but two of the overhoused households to appropriate units. We acknowledged in the report that East Lake created an internal transfer list in response to the finding. In addition, we commend East Lake for taking corrective actions to ensure that its households reside in appropriately sized units. East Lake should work with HUD to resolve recommendation 1G which should ensure that its program units will not be underutilized in the future, if properly implemented.

Comment 3 East Lake contends that a “not-to-exceed guideline” is consistent with HUD’s requirements. We disagree. A “not-to-exceed guideline” does not prevent East Lake from housing a single person in a unit with two or more bedrooms. Therefore, a not-to-exceed guideline is not consistent with HUD’s requirements since it does not take into account the size and number of bedrooms needed based on the number of people in the family to prevent underutilization of space and unnecessary subsidy.

Comment 4 East Lake contends that because it charged the correct amount for each bedroom size, it does not feel that a cash penalty was the appropriate remedy. We disagree. East Lake would have served more participants had it moved smaller households into smaller units so larger families could occupy the larger units, as required by HUD. Questioned funds were the result of the underuse of those units.

Comment 5 East Lake contends that the auditor’s calculations were based on HUD’s Enterprise Income Verification income report and not on verified income as required. Therefore, it determined that there were four households with unreported income. East Lake was in the process of negotiating recoupment agreements with the individuals for a total of $16,000. We based our calculations of the unreported income in the audit report on the actual amounts reported in HUD’s EIV system because that information was available to us. East Lake should work with HUD to resolve the income discrepancies and the recommendation can be adjusted based on the actual verifications.

Comment 6 East Lake contends that there were several cases that the auditor characterized as unreported income that East Lake considered to be timing issues and not a failure to charge appropriate rents. We revised the report to clearly state that the unreported income was due to some households reporting income late.

Comment 7 East Lake contends that in its view, income reported after 30 days was not a failure to adhere to HUD's regulations, but an occasional consequence of complying with competing requirements. Further, it stated that the balance attributable to relatively short timing issues was a function of the process and should not require a cash payment. We disagree. The lease agreements state that tenants should report income immediately. In addition, the household files did not contain notations explaining why a tenant needed more than 30 days to report a change in income.

Comment 8 East Lake contends that it was pursuing recoupment of overpaid subsidy due to unreported income aggressively and should not be required to pay a cash penalty. We disagree that the amount cited was a cash penalty. Recommendation 1C requires the project's owner to reimburse HUD $32,334 for the overpayment of housing assistance due to unreported or underreported income. This reimbursement can be either from non-project funds or collections from the applicable households.

Comment 9 East Lake contends that the errors were not attributable to inadequate quality control and training. We disagree. Neither the president nor a staff person for the management agent provided documentation supporting implementation of the project's quality control process or project files that had been reviewed. Further, the audit report does not state that the errors were due to inadequate training.

Comment 10 East Lake contends that we reviewed 3 years of data and that "if one estimates that 69 files represents approximately $2.5 million in billing for 3 years, than $18,000 represents an error rate of less than 1 percent. We disagree. Our audit period was 2 years. In addition, during the survey phase, we reviewed 64 certifications from the 10 households and during the audit phase, we reviewed 69 certifications from the 59 households. Of the 133 certifications reviewed, we identified 25 certifications that had at least 1 incorrect income calculation, thus resulting in a 19 percent error rate. Further, the sample was designed as a stratified random sample from an audit universe of 3,493 monthly housing assistance payments totaling nearly $3 million. In applying the results of the sample to the audit universe, we estimate that HUD overpaid at least $152,214 during the audit period. Further, in applying our 24-month sample period to a typical 1-year period, we can say that these findings represent $76,107 per year in subsidy payments that could have been avoided by properly administering the program.

Comment 11 East Lake contends, for recommendation 1B, that it would issue tenants rent credits and for recommendation 1D it acknowledged that some deductions were inadequately documented. We commend East Lake for agreeing to take corrective actions. It should work with HUD to resolve the recommendations.

Comment 12 East Lake contends, for recommendation 1E, that it would continue to implement robust quality control training and auditing to continually improve the accuracy of its calculations. It also contends that for recommendation 1F, it had documented its quality control procedures for the auditor and in this correspondence. We commend East Lake for its commitment to training. However, recommendations 1E and 1F in the audit report was for the **implementation** of quality control procedures, and a quality control plan and related process. Therefore, East Lake should work with HUD to resolve and ensure the corrective action meets the intent of these recommendations.

Comment 13 East Lake contends for recommendation 1H, that its internal wait list format now includes notations. However, it did not provide documentation to support its assertions, and it was not specific enough on the type of notations it included in the internal waiting list Therefore, East Lake should work with HUD to sufficiently resolve the recommendation.

Comment 14 East Lake contends, for recommendation 1I, that it was committed to 100 percent compliance with HUD's required procedures and would use the results of this audit to continue to improve. We commend East Lake for its willingness to improve its processes. East Lake should work with HUD to resolve the audit report recommendations.

Appendix C

Federal and the Project's Requirements

HUD's regulations at 24 CFR 5.240(c) state that the responsible entity must verify the accuracy of the income information received from the family and change the amount of the total tenant payment, tenant rent, or program housing assistance payment or terminate assistance as appropriate, based on such information.

HUD Handbook 4350.3, REV-1, paragraph 3-23(A)(1), states that owners must develop and follow occupancy standards that take into account the size and number of bedrooms needed, based on the number of people in the family. Occupancy standards serve to prevent the overuse or underuse of units, which can result in an inefficient use of housing assistance. Occupancy standards also ensure that tenants are treated fairly and consistently and receive adequate housing space. By following the standards described in this paragraph, owners can ensure that applicants and tenants are housed in appropriate size units in a fair and consistent manner as prescribed by law. Occupancy standards must be part of an owner's tenant selection procedures. Section (G)(2) states that a single person must not be permitted to occupy a unit with two or more bedrooms, except for (a) a person with a disability who needs the larger unit for reasonable accommodations, (b) a displaced person when no appropriate size unit is available, (c) an elderly person who has a verifiable need for a larger unit, or (d) a remaining family member of a resident family when no appropriate size unit is available.

Paragraph 5-12(B)(2) of the Handbook states that owners must verify each family's income, assets, expenses, and deductions as part of the annual recertification process.

Paragraph 7-11(C) of the Handbook states that upon receiving a tenant request for an interim recertification, owners must process a recertification of family income and composition within a reasonable time, which is only the amount of time needed to verify the information provided by the tenant. Generally, this should not exceed 4 weeks.

Paragraph 7-16(A)(1) of the Handbook states that if a tenant reports a change or the owner becomes aware of a change in family composition, the owner must determine the appropriate unit size and whether a transfer is required. Owners should use the occupancy standards established for the property to determine whether the unit was the appropriate size for the tenant.

Paragraph 9-8 (A)(1) of the Handbook states that owners must use the Enterprise Income Verification system income discrepancy report as a third-party source to verify a tenant's employment and income during annual and interim recertifications of family composition and income.

Paragraph 9-11(C) of the Handbook states that the Enterprise Income Verification system identifies households for which there is a difference of $2,400 or more annually in the wages, unemployment compensation, or Social Security benefit income reported by the National Directory of New Hires and Social Security Administration and the wages, unemployment compensation, or Social Security benefit income reported in HUD's Tenant Rental Assistance

Certification System for the period of income used for the discrepancy analysis. The report identifies tenants whose income may have been underreported or over reported. Negative numbers on the report represent potential tenant underreporting of income, while a positive number represents a potential decrease in a tenant's income. In either case, the owner must investigate all discrepancies identified to determine whether they are valid.

Paragraph 9-11(C)(3)(c) of the Handbook states that the owner must retain the income discrepancy report, along with detailed information on the resolution of the reported discrepancy in the tenant file, regardless of whether the discrepancy was found to be valid or invalid.

Paragraph 4-15(A) of the Handbook states that once unit size and preference order is determined, owners must select applicants from the waiting list in chronological order to fill vacancies.

Paragraph 4-18(A) of the Handbook states that whenever a change is made in the waiting list, an action is taken, or an activity specific to an applicant occurs, a notation must be made on the waiting list. Paragraph 4-18(B) states that the goal of the annotation is to provide an auditable record of applicant additions, selections, withdrawals, and rejections. Independent reviewers looking at the waiting list should be able to (1) find an applicant on the waiting list; (2) readily confirm that an applicant was housed at the appropriate time, based on unit size needs, preferences, and income targeting; and (3) trace various actions taken with respect to a family's application for tenancy.

Paragraph 4-19(A) of the Handbook states that the owner should update the waiting lists annually or semiannually to ensure that applicant information is current and any names that should no longer be on the list are removed. Paragraph 4-19(B) states that if the household composition changes, the owner must update the waiting list information and decide whether the household needs the same or a different unit size. The owner's written policy will determine whether the family maintains the original application date or the place on the waiting list is based on the date of the new determination of family composition.

Section III (B) of the project's tenant selection plan states that the property will maintain two waiting lists: one for in-house transfer applicants and the other for non-Federal preference applicants. Names on each waiting list will appear in the order of receipt, with priority given to those who qualify for a preference placement on a waiting list; however, this does not guarantee that the person is eligible or acceptable at the property.

Section III (C) of the plan states that applicants will be contacted through the following process: When a unit becomes available and there are no current residents on the in-house waiting list, the top priority number from the nonpreference waiting list for that unit size will be selected. Management will telephone the selected applicant at least three times during the next 48-hour period. If the applicant cannot be reached, a letter will be sent to the applicant requesting a date and time for an interview. If management does not receive a response to the letter within 10 business days from the date the letter was mailed, the applicant will forfeit the opportunity to apply for the available unit but will remain at the top of the applicable waiting list. When a second unit becomes available, management will send another letter to the applicant. This letter will explain that if the applicant does not respond within the period specified, the application will be placed into the inactive file. If the applicant refuses a unit, he or she will remain at the top of the applicable waiting list. However, a letter will immediately be sent informing the applicant that after the second refusal, his or her name will be removed from the applicable waiting list and placed into the inactive file.

Section III (D) of the plan states that following the completion of the initial application, the two waiting lists will be updated at least once every 12 months in the following manner: Management will send a letter to each applicant on each of the waiting lists. The letter will include a reply card to be returned if the applicant is still interested in living at the project. The person will be given 15 days from the date the letter was mailed to respond. If no response is received, the person's name will be placed into the inactive file, and a letter will be sent informing the person of this action. After each of the waiting lists is updated, based on the reply cards returned, a current status letter will be sent to each person informing the person of the position of his or her name within the unit category. The current status letter will also inform the person that it is his or her responsibility to notify the management office of any changes in address, telephone number, or telephone device for the deaf number (if applicable). If the unit size needs changes, based upon family composition, and no appropriate size unit exists in the property, the applicant will be removed from the waiting list. If the applicant no longer meets the eligibility requirements for the property, the applicant will be removed from the waiting list. A letter will be sent to the applicant informing him or her of this action.

Section V of the plan states that when management has determined that a unit transfer is needed, the tenant may (a) remain in the unit and pay the HUD-approved market rent or (b) move within 30 days after management has notified the family that there is a unit of the appropriate size available within the property.