Meeker Family and Elderly Housing, Meeker, CO

221(d)(3) Multifamily Insurance Program

Office of Audit, Region 8
Denver, CO

Audit Report Number: 2018-DE-1001
September 6, 2018

To: Thomas W. Azumbrado, Regional Director, West Multifamily Region, 9AHMLAP

//**signed**//

From: Ronald J. Hosking, Regional Inspector General for Audit, 8AGA

Subject: Meeker Housing Authority, Meeker, CO, Improperly Used Project Operating Funds for Its 221(d)(3) Multifamily Housing Insurance 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 Meeker Family and Elderly Housing.

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 913-551-5870.

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Meeker Housing Authority, Meeker, CO, Improperly Used Project Operating Funds for Its 221(d)(3) Multifamily Housing Insurance Program

Highlights

What We Audited and Why

We audited the Meeker Family and Elderly Housing project based on a referral from the U.S. Department of Housing and Urban Development's (HUD) Office of Multifamily Housing Programs in Denver, CO. The project is owned and managed by the Meeker Housing Authority. HUD alleged that the owner had failed to file audited financial statements or make mortgage payments to HUD for the past 10 years. Our objectives were to determine whether the owner properly maintained its bank accounts, used project funds only for eligible expenses, properly submitted its financial statements and mortgage payments, and conducted eligible project improvements with reserve for replacement funds.

What We Found

The owner did not maintain its bank accounts in the name of the project and did not separate project and owner funds. The owner used operating funds to pay for ineligible and unsupported expenses. It did not submit its annual financial statements to HUD for more than 10 years and did not maintain separate books of account for the ownership entity. It did not make the required mortgage payments on its $1.4 million outstanding mortgage balance. Additionally, the owner improperly used project operating funds to pay for project renovations.

What We Recommend

We recommend that the Director of HUD's West Region Office of Multifamily Housing Programs require the owner to (1) put all project bank accounts in the name of the project; (2) separate all owner bank accounts from the project's bank accounts; (3) develop and implement controls over the distinction between project funds and owner funds, for its use of the project funds, to ensure that the certified public accountant submits audited financial statements and that the project does not use operating funds for any items that qualify for the use of reserve for replacement funds; (4) take HUD-approved training; (5) submit any outstanding audited financial statements; (6) work with the local multifamily office to make any outstanding mortgage payments; (7) repay the project's operating account for the $142,805 spent on ineligible expenses using nonproject funds; (8) reimburse the project's operating account $50,400 from the reserve for replacement account; and (9) provide support for the $12,355 in project funds spent to pay individuals who were not on the payroll.

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Background and Objectives

The Meeker Family and Elderly Housing project is located in Meeker, CO, and is comprised of two properties, the Pines and Karen Court apartments. The Pines apartments are for elderly tenants, and the Karen Court apartments are for low-income tenants. The project is owned and managed by the Meeker Housing Authority. The owner was created in 1973 under section 69-3-4 of The Housing Authorities Law of the State of Colorado. The owner's goal is to provide a decent home and suitable living environment for all (existing and new) residents of Meeker regardless of age, sex, race, creed, or socio-economic status. The following photos show the Pines (pictured left) and Karen Court (pictured right).

The project entered into a restricted use agreement and two regulatory agreements with the U.S. Department of Housing and Urban Development (HUD) during the mortgage loan restructure in 2003. The regulatory agreements were established under the section 221(d)(3) multifamily housing insurance program. Under the 221(d)(3) mortgage insurance program, HUD provides mortgage insurance to finance rental or cooperative multifamily housing for moderate-income households, including projects designated for the elderly. The project was originally financed with a HUD-insured 221(d)(3) loan in 1982 for more than $1.5 million. In 2003, the project went through a Mark-to-Market (M2M) Program mortgage loan restructure. The M2M program preserves affordability and availability of low income rental multifamily properties with federally insured programs. The purpose of M2M is to reduce rents to market levels by restructuring existing debt to levels supportable by these rents. The M2M mortgage loan restructure created two loans with HUD, each for $503,600, and a contingent repayment mortgage note of $949,630.

The project is also under a 20-year Section 8 housing assistance payments contract, and all 36 units of the project receive rental payment assistance. Under the housing assistance payments contract, HUD provides Section 8 rental subsidies to the project owners in an amount equal to the difference between the HUD-approved rent for a particular assisted unit and the HUD-required rental contribution from eligible tenant families.

Our objectives were to determine whether the owner properly maintained its bank accounts, used project funds only for eligible expenses, properly submitted its financial statements and mortgage payments, and conducted eligible project improvements with reserve for replacement funds.

Results of Audit

Finding 1: The Owner Did Not Properly Maintain Its Project Bank Accounts

The owner did not maintain its bank accounts in the name of the project and did not separate project and owner funds. This condition occurred because the owner did not understand its relationship with HUD and was not aware of the regulatory requirements. As a result, project funds were not protected and were used for ineligible expenses.

The Owner Did Not Properly Maintain Its Project Bank Accounts

The owner had three bank accounts designated as the project's operating accounts. However, all three bank accounts were in the name of the owner. According to the regulatory agreement, all rents and other receipts of the project must be deposited in the name of the project into a bank in which deposits are insured by the Federal Deposit Insurance Corporation.

The Owner Did Not Separate Project and Owner Funds

The owner did not maintain bank accounts separate from those of the project, and there was no distinction between which funds belonged to the owner and which belonged to the project. All day-to-day expenses of both the project and owner were paid from the project's operating accounts. According to the regulatory agreement, such funds must be withdrawn only in accordance with the provisions of the agreement for expenses of the project or from distributions of surplus cash. However, as discussed in finding 3 of this report, the owner had not established a surplus-cash position for more than 10 years.

The Owner Did Not Understand Its Relationship With HUD

The owner did not understand its relationship with HUD and was not aware of the regulatory requirements. The owner operated the project as if it were a regular public housing low-rent project when it should have been operated as an owner-managed multifamily insured project. Specifically, the owner was a public housing agency by Colorado State Law but received funds from HUD only as the owner and manager of the multifamily insured project. The owner and the employees were not aware that making disbursements from the operating account was a violation of the regulatory agreement. The owner and employees had not read the controlling documents and agreements with HUD.

Project Funds Were Not Protected

Project funds were not protected and were used for ineligible expenses. Because the bank accounts were not in the name of the project, there was no guarantee that project funds would be spent only for eligible expenses. As discussed in finding 2 of this report, the owner used project funds to pay for ineligible expenses.

Recommendations

We recommend that the Director of HUD’s West Region Office of Multifamily Housing Programs require the owner to

1A. Put all project bank accounts in the name of the project.

1B. Separate all owner bank accounts from the project’s bank accounts.

1C. Develop and implement controls over the distinction between project funds and owner funds. These controls should include policies related to when the owner is allowed to take project funds owed to the owner.

1D. Take HUD-approved training related to operating and maintaining a multifamily project.

Finding 2: The Owner Used Project Funds for Ineligible and Unsupported Expenses

The owner used project operating funds to pay for ineligible and unsupported expenses. This condition occurred because the owner did not have controls over procurement and the eligible use of funds. Additionally, the owner was not aware of the terms and conditions of its agreements with HUD. As a result, more than $142,000 in operating funds was not available to benefit the tenants, and HUD could not ensure that the project got the best value for more than $12,000 of its expenses.

The Owner Used Project Funds for Ineligible and Unsupported Expenses

The owner used project operating funds to pay for ineligible and unsupported expenses. It used more than $142,000 in project funds to pay for owner-related legal fees and a Christmas party. The owner was subject to a housing discrimination lawsuit in 2017. It used project funds to pay for all fees related to the lawsuit. The regulatory agreements state that disbursments from project funds may be used only for reasonable operating expenses and necessary repairs of the project.

The owner paid individuals nearly $8,000 to perform different tasks around the project and it did not maintain proper supporting documents to show what services were performed, the dates the services were performed, and the number of hours it was charged for the services performed. Additionally, the owner could not support services totaling more than $4,000. According to HUD Handbook 4370.2, REV-1, chapter 2 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. The following table shows the breakout of unsupported and ineligible amounts.

Expense	Ineligible amount	Unsupported amount
Legal fees	$142,460	
Christmas party	345	
Payments to individuals		$7,677
No receipts provided		4,678
Totals	**142,805**	**12,355**

The Owner Lacked Controls and Was Unaware of Its Contract Requirements

The owner did not have controls over procurement and the eligible use of funds. It did not have written policies for procurement, travel, or the use of its credit cards. With no policies in place, the owner failed to obtain the required written or verbal cost estimates.

The owner was not aware of the terms and conditions of its agreements with HUD. At the time of the audit, the owner had not read its regulatory and management agreements with HUD. It did not know that using the project's operating funds for expenses other than project operations was not allowed.

Project Operating Funds Were Not Available for Tenants

As a result of the conditions described above, the more than $142,000 in operating funds spent on legal fees and a Christmas party were not available to benefit the tenants. Additionally, HUD could not ensure that the project got the best value for more than $12,000 in expenses that the owners could not adequately support.

Recommendations

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

2A. Repay the project's operating account from nonproject funds for the $142,805 spent on ineligible expenses.

2B. Provide support for the $12,355 in project funds spent to pay individuals who were not on the payroll and for services provided for project operations. For any portion of this amount that is not supported, the owner should repay the project operating account using nonproject funds.

2C. Obtain training on the eligible use of project funds.

2D. Develop and implement detailed policies and procedures for procurement, travel, and the use of its credit cards. These controls should comply with HUD regulations regarding procurement and other disbursement documentation requirements.

Finding 3: The Owner Did Not Submit Its Annual Audited Financial Statements

The owner did not submit its annual audited financial statements to HUD for more than 10 years and did not maintain separate books of account for the ownership entity. This condition occurred because the owner relied solely on its certified public accountant to submit the financial statements to HUD, did not have controls to verify the submission of the statements, and did not fully understand the nature of the relationship between the ownership entity and the project. As a result, the project's restricted surplus cash was not calculated annually, and the owner did not make the required mortgage payments on its $1.4 million outstanding mortgage balance. Additionally, the project's financial statements might have been misstated due to the comingling of the owner's assets and expenses.

The Owner Did Not Submit Annual Audited Financial Statements to HUD

The owner did not submit its annual audited financial statements to HUD for more than 10 years. In 2009, HUD's Department Enforcement Center started notifying the owner of its noncompliance related to not submitting its financial statements. Although the owner received the notices starting in 2009, it did not submit annual statements until 2017. The owner hired a new accountant in September of 2017 and submitted audited financial statements for fiscal years 2006, 2007, 2008, 2011, 2012, and 2013. At the time of our audit, the new accountant was working to submit the remaining financial statements. The regulatory agreement required the owner to submit audited financial statements to HUD within 60 days following the end of each fiscal year.

The Owner Did Not Maintain Separate Books of Account

The owner did not maintain separate books of account for the ownership entity. The owner's and the project's books and records were comingled and not in accordance with the requirements of the regulatory agreement.

The Owner Lacked Controls Over Project Requirements

The owner relied solely on its accountant to submit the financial statements to HUD. It explained that it paid an accountant every year to complete the audited financial statements but the accountant did not submit the statements to HUD. The owner did not have controls to verify the submission of the statements. With controls in place, the owner might have submitted its financial statements annually. Additionally, as discussed in finding 1, the owner did not fully understand the nature of the relationship between the ownership entity and the project.

The Project's Surplus Cash Was Not Calculated

Due to the owner's failure to submit audited financial statements, the surplus cash amounts were not generated in HUD's Financial Assessment Subsystem (FASS). FASS is a system that is used by property owners to report owner certified and/or audited financial information to HUD. Without the required surplus cash calculation, the owner was not able to make the required mortgage payments on its $1.4 million outstanding mortgage balance. The annual mortgage payment is calculated as 75 percent of the restricted surplus cash earned annually. Additionally, because the owner did not maintain separate books of account, the project's financial statements might have been misstated due to the comingling of the owner's assets and expenses.

Recommendations

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

3A. Submit any outstanding audited financial statements.

3B. Review the audited financial statements and determine the amount of outstanding mortgage payments due.

3C. Work with the local multifamily office to make any outstanding mortgage payments or devise a plan to bring the property current through the use of available funds.

3D. Develop and implement policies and procedures to ensure that the certified public accountant submits audited financial statements by the required HUD deadline.

3E. Maintain separate books of account and submit audited financial statements solely for the project.

Finding 4: The Owner Improperly Paid for Project Renovations Using Project Funds

The owner improperly used project operating funds to pay for project renovations. This condition occurred because the owner was not aware of the HUD requirements for using its reserve for replacement funds. As a result, more than $50,000 in the projects operating funds was not available for the day-to-day operations of the project.

The Owner Improperly Used Project Funds

The owner improperly used project funds to purchase new equipment and remodel kitchens. From fiscal years January 2015 through December 2017, the owner spent more than $50,000 in project funds to purchase refrigerators, stoves, and for full kitchen remodels. According to HUD Handbook 4370.2, REV-1, chapter 2, project funds should be used only to make mortgage payments, make required deposits to the reserve for replacement fund, pay reasonable expenses necessary for the operation and maintenance of the project, pay distributions of surplus cash permitted, and repay owner advances authorized by HUD.

The Owner Was Not Aware of the HUD Requirements

The owner was not aware of the HUD requirements for using reserve for replacement funds. It did not know that the reserve for replacement account existed, how much it had deposited into the account on a monthly basis, or who to contact in order to request the funds from the account. The owner lacked policies and procedures for how to properly use the reserve for replacement funds.

The Project's Operating Funds Were Not Available

More than $50,000 of the project's operating funds were not available for the day-to-day operations of the project. As of December 2017, the reserve for replacement account had a balance of $124,895.

Recommendations

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

4A. Reimburse the project's operating account $50,400 from the reserve for replacement account.

4B. Receive training on the proper use of its reserve for replacement account.

4C. Develop and implement policies and procedures for the use of reserve for replacement funds, which ensure that the project does not use operating funds for any items that qualify for the use of reserve for replacement funds.

Scope and Methodology

Our audit work covered Meeker Housing Authority's records from January 1, 2015 to December 31, 2017. We performed our work from January through April 2018 at the Meeker Family and Elderly Housing apartments located at 875 Water Street, Meeker, CO.

To accomplish our objective, we

- reviewed the project's financial records from January 1, 2015, to December 31, 2017;
- reviewed policies and procedures;
- reviewed applicable HUD rules and regulations;
- reviewed the referral from the Office of Multifamily Housing Programs;
- reviewed the Mark-to-Market Program mortgage restructure loan documents;
- reviewed the regulatory agreements and contracts;
- reviewed Departmental Enforcement Center referrals;
- interviewed HUD staff in charge of the project;
- interviewed the owner and staff members; and
- interviewed Colorado Housing Finance Agency and the Department Enforcement Center officials.

We reviewed all bank statements and QuickBooks financial data from January 1, 2015, to December 31, 2017. The total amount of disbursements during this period was more than $985,500. We reviewed 100 percent of the disbursements in our audit period and requested supporting documentation for any disbursements that appeared to be nonoperating expenses of the project. The supporting documentation included invoices, bank statements, descriptions of services performed, and check registers from QuickBooks. Additionally, we conducted interviews to gain information on the lack of payments on the mortgage and lack of submissions of audited financial statements.

We did not rely on the computer-processed data to support our audit conclusion. We used the computer-processed data as background information. We based our conclusions on our review of the source documentation.

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 objectives.

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 objectives:

- Controls to ensure that the owner properly maintained its bank accounts and books of account and submitted audited financial statements to HUD.
- Controls to ensure that project funds were used only for eligible expenses and that eligible project improvements were paid for from reserve for replacement funds.

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 Deficiencies

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

- The owner lacked controls to ensure that the project's bank accounts were administered properly (finding 1).
- The owner lacked controls to ensure that project funds were used only for eligible expenses (finding 2).
- The owner lacked controls to ensure that annual audited financial statements were submitted annually (finding 3).
- The owner lacked controls to ensure that eligible project improvements were paid for from reserve for replacement funds (finding 4).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/	Unsupported 2/
2A	$142,805	
2B		$12,355
4A	50,400	
Totals	**193,205**	**12,355**

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

The owner declined the opportunity to provide a written response.