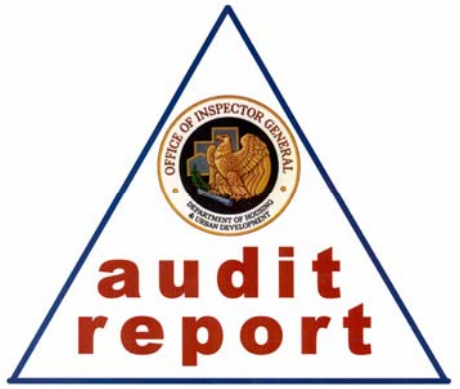

Issue Date
August 14, 2007
Audit Report Number
2007-AT-1010

TO: James D. Branson, Director, Jacksonville Multifamily Housing Hub, 4HHMLAS

Donzella B. Hamm, Director, Departmental Enforcement Center, CVS4

James D. McKay

FROM: James D. McKay
Regional Inspector General for Audit, 4AGA

SUBJECT: The Cathedral Foundation of Jacksonville, Inc., Jacksonville, FL Used More Than $2.65 million in Project Funds for Questioned Costs

HIGHLIGHTS

What We Audited and Why

We audited the Cathedral Foundation of Jacksonville, Inc. (Foundation), concerning its involvement as owner and/or manager of four elderly multifamily housing projects (projects) located in Jacksonville, Florida. We conducted the audit based on a request from the Jacksonville Multifamily Housing Hub, U.S. Department of Housing and Urban Development (HUD), Jacksonville, Florida. Our audit objective was to determine whether the Foundation operated the four projects in accordance with HUD's regulatory agreements and other applicable laws, regulations, and requirements.

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What We Found

The Foundation used more than $2.65 million in project funds for questioned costs while the projects had no surplus cash and without required HUD approval. The questioned amount included $1.35 million, which the Foundation repaid itself without HUD approval for project advances and $1.30 million for questioned costs for salaries, fringe benefits, janitorial services, retirement plan, parking fees, and other costs. The questioned costs violated federal statutes, regulations, contracts, and other HUD requirements. The Foundation and subsidized project owners also collected $93,677 in prohibited parking fees from tenants. The prohibited parking fees placed an unjustified financial burden on the tenants. The violations occurred because the Foundation and project owners did not follow HUD's and other requirements.

What We Recommend

We recommend that the director of HUD's Jacksonville Multifamily Housing Hub require the Foundation and project owners to deposit to the project's residual receipt accounts more than $2.5 million for ineligible, unreasonable, or unnecessary costs and repay any portion of the $147,277 in unsupported costs that it cannot document as reasonable and necessary costs for the projects. We further recommend that the director require the Foundation and the owners of the projects to reimburse $93,677 to tenants who paid prohibited parking fees.

We also recommend that the director of the Departmental Enforcement Center, in coordination with the director of the Multifamily Division, Jacksonville Hub, take appropriate administrative action against the Foundation and project owners for not complying with requirements.

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

Auditee's Response

We provided our discussion draft audit report to the Foundation on May 2, 2007. We held an exit conference on May 10, 2007. The Foundation provided written comments on May 21 2007. It generally disagreed with our report findings.

The complete text of the Foundation's written response, along with our evaluation of that response, can be found in appendix B of this report. Attachments were not included in the report, but are available for review upon request.

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BACKGROUND AND OBJECTIVES

The Cathedral Foundation of Jacksonville, Inc. (Foundation), was established on August 21, 1962, as a 501(c) (3) nonprofit charitable organization sponsored by the St. John's Episcopal Cathedral. The Foundation's mission is to create a better way of life for elderly tenants throughout the Jacksonville community through the ownership, operation, administration, and management of housing and community service programs.

Through May 31, 2006, the Foundation managed one U.S. Department of Housing and Urban Development (HUD) Section 236 and three HUD Section 202 elderly projects located in downtown Jacksonville, Florida. The Foundation owned two of the projects. A board of directors oversaw the operations of each project. The same individual served as the chairman of the board of directors for each of the projects.

Projects	Owner	Date of regulatory agreement	Program and type of funding	Number of units
Cathedral Towers (Towers)	Cathedral Foundation of Jacksonville, Inc.	January 21, 1966	202*	202
Cathedral Townhouse (Townhouse)	Cathedral Foundation of Jacksonville, Inc.	June 12, 1968	202*	179
Cathedral Terrace (Terrace)	Cathedral Terrace, Inc.	November 29, 1972	236/Section 8	240
Cathedral Court (Court)	Cathedral Court, Inc.	December 28, 1979	202/Section 8	16
Total				637

*Includes section 8 provided through Loan Management Set-Aside Program.

The Foundation relinquished management of the four projects, effective June 1, 2006, to another management firm that had no identity of interest with the Foundation and owners of the projects. The change followed concerns that HUD raised about the Foundation's management although HUD had not formally required the owners to obtain new management. The Foundation also made changes in its senior management and hired new personnel. The most recent problems surfaced during HUD's December 2005 management review. HUD requested the audit due to concerns that included questionable costs while the projects had no surplus cash, no funding of residual receipts, and no repayments on more than $10 million in flexible subsidy loans.

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Projects	Flexible subsidy loan date	Individual loan amount	Total loan amount
Terrace	July 1, 1992	$1,824,227	
	August 1, 1994	1,386,132	$3,210,359
Towers	October 1, 1993	$1,990,532	
	December 1, 1997	960,673	
	October 1, 2002	271,934	$3,223,139
Townhouse	October 1, 1993	$2,518,634	
	October 12, 1998	1,015,796	
	October 1, 2000	261,617	$3,796,047
Total			$10,229,545

The audit objective was to determine whether the Foundation operated the four Projects in accordance with HUD's regulatory agreements and other applicable laws, regulations and requirements.

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RESULTS OF AUDIT

Finding 1: Mismanagement of Project Funds Resulted in More Than $2.65 Million Disbursed for Questioned Costs

The Foundation and/or the owners of the four projects used project funds to pay more than $2.65 million in questioned costs. The payments occurred while the projects had no surplus cash and without HUD approval. A significant portion of the costs represented Foundation expenses or markups that were not reasonable and necessary costs for the projects. The $2.65 million violated federal statutes, the project's regulatory agreements, HUD regulations, HUD handbook requirements, and the Foundation's management contracts with owners of the projects. The violations occurred because the Foundation and owners did not follow HUD's statutes and other requirements. The questioned costs reduced the availability of cash needed to fund the projects operations.

The $2.65 million includes more than $2.02 million for improper charges, $484,407 for unreasonable or unnecessary costs, and $147,277 for costs that were not properly supported.

Description	Ineligible Costs	Unreasonable or unnecessary costs	Costs not properly supported	Total
Repayment of advances	$1,357,238			$1,357,238
Salary and fringe costs	656,536*			656,536
Janitorial costs		$458,101*		458,101
Retirement plan costs		26,306*	115,372	141,678
Parking fees			31,905	31,905
Other costs	6,352*			6,352
Total	$2,020,126	$484,407	$147,277	$2,651,810

*These amounts, which total $1,147,295, were for Foundation costs and excessive markups, which were improper charges to the projects that benefited the Foundation.

Federal statutes provide for civil and other remedies for unauthorized use of multifamily project assets and income used in violation of the regulatory agreement or any applicable regulation. The statutes apply to regulatory agreement violations such as paying out any funds for expenses that were not reasonable and necessary for project operation.

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Inappropriate Repayment of Advances

HUD Handbooks 4370.1, paragraph 2-21(F)(3)(a) and 4370.2, paragraph 2-6(e), allow owners and management agents to use surplus cash at the end of annual or semiannual periods to repay advances, provided they obtain HUD's prior approval.

The Foundation inappropriately used more than $1.35 million from four projects to repay itself for advances shown in the project's general ledgers. The advances were not repaid from surplus cash, and without HUD's prior approval. The repayments consisted of the following amounts.

Projects	Inappropriate repayment of advances
Terrace	$654,183
Towers	$325,354
Townhouse	$268,210
Court	$109,491
Total	$1,357,238

In June 2006, a new independent management firm took over management of the four projects. From that time through the time of our on-site review, February 2007, the Foundation and owners did not need to advance funds to the projects for their operations.

Inappropriate Salary and Fringe Costs

The Foundation used funds from the four projects to pay $656,536 for its salary and fringe costs, which it improperly charged to the projects. The amounts included

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- $244,460 for the Foundation's administrator. The administrator's primary duties included oversight and supervision of project operations and personnel. The duties were included in the Foundation's management contracts with the projects. The projects paid for the administrator's services when they paid the Foundation's management fee. Thus, it was improper for the Foundation to also directly charge the projects for costs associated with its administrator.

Projects	Payroll costs
Terrace	$92,814
Towers	68,468
Townhouse	75,816
Court	7,362
Total	$244,460

- $412,076 charged for four positions that involved duties covered by the projects' management contracts with the Foundation. From October 2003 to May 2006, the projects paid $412,076, which represented all of the payroll and fringe costs for the workers. However, their job descriptions and our discussions with the workers and Foundation officials showed that the workers also performed Foundation duties. The Foundation did not require and maintain employee time distribution records to support time the Foundation claimed that the workers also spent performing project duties. HUD officials had similar concerns about the costs.

Projects	Business office manager	Director of facility operations	Administrative secretary	Director of support services	Total
Terrace	$44,249	$57,001	$32,188	$23,150	$156,588
Towers	32,604	42,000	23,717	17,058	115,379
Townhouse	36,098	46,501	26,259	18,885	127,743
Court	3,494	4,501	2,542	1,829	12,366
Total	$116,445	$150,003	$84,706	$60,922	$412,076

Excessive Janitorial Costs

The Foundation charged the four projects $458,101 in excessive fees for janitorial work it performed. The charges exceeded the amount the Foundation would have incurred if it had awarded the janitorial work through a contract with one of three lower bidders that responded to its 1999 request for proposal for the work.

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The regulatory agreements for each of the projects provide that payment for services, supplies, or materials shall not exceed the amount ordinarily paid for such services, supplies, or materials in the area where the services are rendered or the supplies or materials furnished.

The Foundation did not provide documentation to explain why it disregarded the lower bids and awarded the work to itself at a higher price. It provided various documents related to the bid process. The documents contained a list of six bids including a bid from the Foundation. The documentation also included a letter from the Foundation, thanking a seventh firm for its bid, but did not include a bid from the firm. The bids submitted by three firms were less than the Foundation's bid. One of the lower bids was from a firm that had been doing janitorial work at the projects for about a decade. On July 9, 1999, the Foundation wrote to that firm, stating that it had selected the Foundation's housekeeping division to do the work. The letter contained nothing to indicate that the firm's bid was not responsive to the proposal. The Foundation provided no record or correspondence with other low bidders concerning their responsiveness to the proposal and why it did not select the lowest bid.

Effective August 16, 1999, the Foundation awarded the work to itself, adjusted the scope of work, and increased its price by more than $2,000 per month. The records provided showed no evidence that the Foundation gave the other bidders an opportunity to review the revised scope of work and to adjust their bids. After selecting itself to do the work, the Foundation did not execute or provide a contract for the work. Thus, the Foundation provided no binding agreement that governed the scope of work, the projects to be served, the frequency of the services, and the cost for the services.

We calculated the excessive amount ($458,101) from October 1, 1999, through May 31, 2006. We based the excessive amount on the 1999 bid submitted by the firm the Foundation had used for about a decade for portions of the projects' janitorial work. We increased the bid price annually by the average 2.7 percent inflation factor calculated based on the consumer price index.

Projects	Janitorial fees charged	Estimate based on submitted bids	Excessive fees
Terrace	$387,664	$214,552	$173,112
Towers	295,456	163,520	131,936
Townhouse	312,482	172,943	139,539
Court	30,262	16,748	13,514
Total	$1,025,864	$567,763	$458,101

That firm's bid was higher than the bids submitted by two other firms, but it was lower than the Foundation's bid. Based on the two lowest bids, the excessive costs from October 1999 through May 2006, after adjustment for inflation, amounted to $723,584 and $641,493, respectively.

Inappropriate Retirement Plan Costs

HUD's Management Agent Handbook, 4381.5, REV-2, paragraph 6-38(e), allows the cost of retirement plans only for permanent front-line staff that work full time at a project. Off-site employees and temporary or part-time on-site employees are not eligible. The requirements further provide that rotating employees working at more than one project are not eligible unless they qualify as full-time employees at one project. Notice 05-08 defines full time as more than 20 hours per week.

The Foundation charged the four projects $141,678 for questioned retirement plan costs. The amount included $115,372 that was not supported as meeting HUD requirements and $26,306 that exceeded the Foundation's cost.

Projects	Not properly supported	Excessive charge	Total
Terrace	$44,370	$10,400	$54,770
Towers	31,925	6,915	38,840
Townhouse	35,459	7,936	43,395
Court	3,618	1,055	4,673
Total	$115,372	$26,306	$141,678

- The $115,372 was for retirement plan cost for employees the Foundation could not support as full time workers (20 hours per week) at any one project. In each case, the individuals worked exclusively from offices located at one of the four projects. However, from those locations, they performed work for multiple projects, and the Foundation distributed their salary costs to the benefiting projects. Foundation officials stated that it made good business sense to have full-time employees work at multiple projects and that this should not cause them to be considered less than full time for the purpose of the retirement benefits.

- The $26,306 exceeded what the Foundation paid under the retirement plan. The Foundation accrued retirement plan costs based on budget estimates. At year-end, it did not adjust the estimates to reflect actual costs. As a result, between October 1, 2003, and December 31, 2005, the Foundation charged the projects $26,306 more than it paid for the retirement plan. The Foundation agreed with the excess cost calculation.

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Inadequately Supported Charges for Parking

The Foundation used $31,905 in project funds to pay itself for inadequately supported employee and guest parking fees. The fees were for a parking lot the Foundation owned that was located adjacent to the projects. The Foundation did not provide or execute a contract for the parking and it could not identify the name and or number of employees and guests covered by the fees. The charges occurred from October 2003 to December 2005. Without proper documentation, we could not determine if the costs were appropriate. The Foundation stopped the practice in December 2005 when HUD questioned the charges, but it did not support or reimburse the $31,905.

Projects	Parking fees
Terrace	$12,124
Towers	8,933
Townhouse	9,891
Court	957
Total	$31,905

Other Costs

The Foundation charged the projects $6,352 for travel and training for staff discussed in the above section whose services and salary represented Foundation costs.

Projects	Training	Travel	Total
Terrace	$258	$2,168	$2,426
Towers	191	1,597	1,788
Townhouse	211	1,769	1,980
Court	20	138	158
Total	$680	$5,672	$6,352

Conclusion

The $2.65 million in questioned costs reduced the availability of cash to fund the projects operations and adversely affected the projects' ability to generate surplus cash. Surplus cash, when generated, for these nonprofit projects should be deposited into residual receipts. Three of the project owners pledged residual receipts as security for more than $10 million in flexible subsidy loans. For the period October 1, 2003, through September 30, 2006, the projects' financial statements showed no surplus cash. The fourth project did not have any flexible subsidy loans.

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When asked why these conditions occurred, the project's board chairman[1] stated that the board had asked similar questions but did not have all the answers. The chairman, however, cited a lack of knowledge and due diligence in complying with HUD guidance/regulations as contributing factors. The chairman said that the boards were active in their oversight of the projects; however, they were not aware that the Foundation was not adequately responding to HUD's questions until they received a registered letter from HUD in December 2005. The chairman stated that up to that point, Foundation managers had not informed the board of the problems raised by HUD.

The Foundation and project owners either knew or should have known the requirements and implemented appropriate action to enforce compliance. The Foundation and owners have been involved with the four HUD-insured projects for more than 26 years and should have been familiar with the related statutes, regulations, contracts (regulatory agreements and management contracts), handbooks, and other HUD requirements.

Recommendations

We recommend that the director of the Multifamily Division, Jacksonville Hub, require the Foundation and the owners of the four projects to

1A. Reimburse the projects from nonproject sources $1,357,238 million for improper repayment of advances. The repayments should be deposited to the residual receipt account for each affected project.

1B. Reimburse from nonproject sources $656,536 for salary and benefits that represented Foundation costs. The repayments should be deposited to the residual receipt account for each affected project.

1C. Reimburse from nonproject sources $458,101 that the Foundation paid itself for excessive janitorial costs. The repayments should be deposited to the residual receipt account for each affected project.

1D. Reimburse from nonproject sources any portion of $115,372 for retirement plan costs that it cannot support as representing necessary and reasonable project costs. The repayments should be deposited to the residual receipt account for each affected project.

1E. Reimburse from nonproject sources $26,306 that the Foundation paid itself for excessive retirement plan costs. The repayments should be deposited to the residual receipt account for each affected project.

[1] The same individual served as chairman of the board of each of the four projects.

1F. Reimburse from nonproject sources any portion of $31,905 in parking fees that it cannot support as representing necessary and reasonable project costs. The repayments should be deposited to the residual receipt account for each affected project.

1G. Reimburse from nonproject sources $6,352 representing Foundation expenses. The repayments should be deposited to the residual receipt account for each affected project.

We also recommend that the director of the Departmental Enforcement Center, in coordination with the director of the Multifamily Division, Jacksonville Hub

1H. Take appropriate administrative action against the Foundation and owners for not complying with statutes, regulations, contracts (e.g., regulatory agreements and management contracts), handbooks, and other HUD requirements.

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Finding 2: Tenants of Subsidized Projects Were Inappropriately Charged for Parking

The subsidized projects inappropriately charged tenants $93,677 for parking fees prohibited by HUD requirements. The parking fees created an unjustified financial burden on the tenants. This condition occurred because the Foundation and owners did not comply with HUD's requirements.

HUD Handbook 4350.1, REV-1, does not allow subsidized project owners to charge tenants for residential parking. The four projects were each approved as HUD subsidized projects under Sections 202 or 236 of the National Housing Act.

From October 2003 to December 2005, the subsidized projects inappropriately collected $93,677 in parking fees from tenants. In December 2005, the projects stopped the practice based on a directive from HUD. However, the projects did not reimburse the tenants.

Projects	Parking fees collected
Terrace	$26,492
Towers	27,106
Townhouse	38,050
Court	2,029
Total	$93,677

Recommendation

We recommend that the director of the Multifamily Division, Jacksonville Hub, require the Foundation and owners of the four subsidized projects to

2A. Reimburse current tenants for any portion of the $93,677 they paid for prohibited parking fees. Parking fees collected from tenants who have moved and for whom it is not feasible to locate them to make the payments should be deposited to the projects' residual receipt accounts.

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SCOPE AND METHODOLOGY

We performed the review from July 2006 to February 2007 at locations in Jacksonville, Florida, for HUD, the four projects, the Foundation, and our office. The review generally covered the period October 1, 2003, through May 31, 2006. We adjusted the period when necessary. To accomplish our objectives, we

- Interviewed officials of the Jacksonville HUD Multifamily Housing Hub and the Foundation, the former management agent, and Jeffrey Charles, Inc., the current management agent.
- Reviewed and obtained an understanding of the Foundation's internal controls and control environment.
- Reviewed applicable statutes, regulations, contracts (e.g., project regulatory agreements, management agreements, management plans, and management certifications), HUD handbooks, and other program requirements.
- Reviewed HUD's files, including management reviews and related correspondence concerning the projects' operations and monthly accounting reports for the projects submitted to HUD by the Foundation and current management agent.
- Reviewed the projects' and the Foundation's audited financial statements for fiscal years ending in 2004 and 2005, the projects' unaudited financial statements for 2006, and the Foundation's 2005 Form 990, Return of Organization Exempt from Income Tax, submitted to the Internal Revenue Service.
- Reviewed the projects' and Foundation's financial records such as general ledgers, bank statements, journal vouchers, check vouchers, cancelled checks, invoices, contracts, bid documents, and other supporting documents for $3,445,220 of the $12,072,126 recorded as costs for the four projects during the audit period. We also reviewed 100 percent of the $1.35 million that the projects repaid the Foundation for advances. We selected transactions based on concerns raised by HUD, vendor characteristics (e.g., related party transactions), dollar amounts, and other factors we considered relevant to the selection of audit samples. We used audit software to retrieve and analyze electronic accounting data the Foundation downloaded from the general ledger for itself and the projects.

We performed the review in accordance with generally accepted government auditing standards.

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INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

We determined the following internal control was relevant to our audit objectives:

- Policies and procedures that management has in place to reasonably ensure that the four HUD-insured elderly projects were operated in accordance with the regulatory agreements, applicable laws, and other HUD requirements.

Significant Weaknesses

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

Based on our review, the Foundation and owners did not have adequate controls to ensure that funds for the four projects were only used for reasonable and necessary expenditures that complied with terms of the projects' regulatory agreements, statutes, regulations, and other HUD requirements. The weaknesses were eliminated when the Foundation relinquished control of the projects and hired an independent agent.

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APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unreasonable/ unnecessary 2/	Unsupported 3/	Funds to be put to better use 4/
1A	$1,357,238			
1B	656,536			
1C		$458,101		
1D			$115,372	
1E		26,306		
1F			31,905	
1G	6,352			
2A				$93,677
Total	$2,020,126	$484,407	$147,277	$93,677

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.

2/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that a prudent person would incur in conducting a competitive business.

3/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

4/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if the Foundation and project owners implement our recommendation, they will correct the improper financial obligation placed on the tenants by the prohibited parking fees.

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Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

The Cathedral Foundation

May 21, 2007

James D. McKay
Regional Inspector General for Audit
U.S. Department of HUD
Region 4, Office of Inspector General
Office of Audit
75 Spring Street, S.W., Room 330
Atlanta, GA 30303-3388

Dear Mr. McKay:

Thank you for this opportunity to respond to the HUD Office of Inspector General's ("OIG") draft audit report regarding The Cathedral Foundation of Jacksonville, Inc. ("CFI" or the "Foundation"). The following is a summary of our main concerns. You will find the body of our response along with supporting documentation attached.

The Cathedral Foundation, Inc. is the leading elderly services agency in Duval County, Florida, and provides critically needed affordable housing and other social services to more than 5,000 frail and vulnerable seniors in the greater Jacksonville area each year. The 637 units of affordable housing that are the subject of this audit are highly valued in our community, and have been highly regarded by HUD.

CFI has enjoyed a strong partnership with HUD over its more than 40 year history of providing quality housing services to needy Jacksonville senior citizens. Its properties are well cared for, as evidenced by their excellent physical inspection scores, and the properties' financial operations have been fully disclosed to HUD via audited financial statements and various monthly and annual reports over decades, which have always been acceptable to HUD.

CFI has been completely open and cooperative with HUD and the OIG, and understands the duty of the OIG to evaluate our performance and compliance. Even before the audit began, we made significant management changes and reimbursed the properties when warranted. We remain committed to continuing this spirit of cooperation and taking responsibility when we are at fault, but we cannot let what appears to be an overzealous and flawed audit bring us to our knees financially and endanger our mission and the wellbeing of thousands of seniors. We are willing to reimburse the properties for over $500,000 in order to settle this matter, because some areas are still open to question and interpretation.

Comment 1

The OIG review of Foundation activities is based on a surprisingly distorted analysis of the flow of funds within CFI itself, and the OIG places an improper reliance on literal

"creating opportunities for our elders to lead meaningful, purposeful lives"

4250 Lakeside Drive • Jacksonville, Florida 32210 • (904) 807-1300 • Fax (904) 807-1351

Comment 2

interpretations of HUD guidance materials that exist to shape HUD oversight, not to burden property management with requirements that fly in the face of efficient operations and generally acceptable approaches, and are not prohibited by regulation or statute. Such materials are open to interpretation and modification and do not enjoy the force of law. In addition, the OIG has elected to adopt the strictest possible interpretation of such guidance materials to the detriment of CFI and to the possible effect of crippling our ability to carry out our many worthwhile activities that further HUD's own goals.

We specifically disagree with many of the OIG's findings, but want to take responsibility for any mistakes that were made:

- The OIG used a flawed methodology to arrive at a demand of over $1.3 million dollars for allegedly improper repayment of owner advances. A more appropriate calculation of the possible amount that may be owed to the properties is closer to $110,000, and nowhere near the OIG estimate.

- The OIG calls for a return of nearly $660,000 of our property staff costs for five employees and alleges these to be inappropriate. We can see that two of those employees arguably could have been paid for with non-project funds and are willing to reimburse $145,000.

- The OIG asserts that our janitorial costs were too high by $460,000. We believe a flawed and aggressive methodology was used to arrive at this estimate. We can see that bidding records regarding these services might have been somewhat deficient, and would be willing to reimburse $240,000 to $290,000, depending on the calculation methodology chosen.

- The OIG states that none of the retirement benefits for certain employees should be an allowed expense, because each employee worked at all four properties and technical record-keeping guidelines were not followed to the letter, even though the OIG *agrees with us that all employees worked full time for the four properties and would be entitled to retirement benefits but for the technical error.* The OIG inappropriately demands that all of the retirement contributions of these hard-working employees be disallowed to the amount of $115,000. We believe that all of these retirement benefits were legitimately earned, are a permissible property expense, and were appropriately divided amongst the four properties.

- The OIG recommends that CFI reimburse the properties and residents for over $100,000 in parking fees that were charged, *even though these charges were allowed under HUD's own practices and even though HUD approved these charges in advance on annual budgets submitted for their approval.* None of these fees should be disallowed.

The exclusive beneficiaries of CFI's activities have been its residents whom it so ably serves. There has been absolutely no private inurement, and the HUD-assisted properties have not been harmed by any of the Foundation's activities.

Comment 3

In the end, we are left with the conclusion that the OIG should revise its draft audit report as it contains many erroneous conclusions. The OIG's interpretation of HUD policy guidance materials must be revisited to follow settled legal principles. The OIG should revise its methodology of calculating fund movements and utilize more appropriate cost comparisons.

Comment 4

In addition, the OIG should not be calling for the Departmental Enforcement Center to take further actions against CFI, penalizing us further on top of substantial repayments given our record of excellent relations with HUD, significant changes already made to management, procedures and controls, excellent performance over decades of working with HUD, and full cooperation with HUD and the OIG, including a willingness to repay very significant amounts.

Comment 5

In order to resolve the audit findings, and avoid the enormous amount of time and additional expense that would otherwise be required of both HUD and CFI to review each item and negotiate appropriate and fair resolutions, CFI is willing to pay $527,100 back to the properties. Given the current outstanding obligations of the Foundation, CFI would need a multi-year repayment plan to accomplish this. We hope that you accept this good faith offer which we extend in spite of the significant burden it will put on the financing of our programs.

We look forward to resolving these issues cooperatively in a manner that the OIG agrees would not extinguish the mission of the Foundation nor put the residents and the valuable programs that CFI administers at risk. Should you have any questions about our attached response, please feel free to contact me at (904) 279-9266.

Sincerely,

John Q. Anderson
Chairman of the Board

Attachment

cc: James D. Branson, Director, Jacksonville Multifamily Housing Hub
Donzella B. Hamm, Director, Atlanta Departmental Enforcement Center
CFI Board of Directors
Lisa A. Tunick, Esq., Hessel and Aluise, P.C.

The Cathedral Foundation, Inc. Response To the HUD Office of Inspector General Draft Audit Report

The Cathedral Foundation of Jacksonville, Inc. ("CFI" or the "Foundation") is a 501(c)(3) nonprofit faith-based charitable organization sponsored by St. John's Episcopal Cathedral with a mission to serve and improve the lives of the elderly residing in Jacksonville, Florida. Over its nearly 45 year history, CFI has consistently provided high-quality housing and valuable community services to a vulnerable and needy senior population. The Foundation enjoys an excellent reputation in the community, and estimates that it has ably housed thousands of seniors over more than 40 years.

In addition to elder housing, the Foundation provides a wealth of valuable community services to more than 5,000 frail and vulnerable seniors per year in the greater Jacksonville area, including Meals on Wheels, in-home nursing services and counseling. CFI, through its affiliated entity Urban Jacksonville, Inc., is the designated lead agency for provision of elderly services in Duval County, Florida. Like most nonprofit service providers, the Foundation stretches to serve as many needy seniors as possible with the limited resources at its disposal. This legacy of wide-ranging service is now in danger and at risk of termination following issuance of the HUD Office of Inspector General's ("OIG") draft audit report and recommendations.

During the middle to late 1960s, the Foundation built two Section 202 elderly residential facilities (Cathedral Towers and Cathedral Townhouse), and in the 1970s added another Section 202 community (Cathedral Court) and a Section 236-insured facility (Cathedral Terrace), for a total of 637 HUD-assisted units. The two oldest properties (Cathedral Towers and Cathedral Townhouse) are owned by the Foundation itself, while Cathedral Court and Cathedral Terrace are owned by affiliated single-asset entities. All of the properties were self-managed up until May 31, 2006, following HUD's requirement to change management agents.

CFI's residential properties are well cared for as evidenced by their excellent Real Estate Assessment Center (REAC) physical inspection scores that consistently rank in the 90s, earning the status of Standard 1 Performing Properties.[1] Up until late 2005, CFI regularly received satisfactory management and operations review ratings, and enjoyed a cooperative relationship with HUD. Each year, CFI and its affiliates filed audited financial statements with HUD that fully disclosed the breadth of all operations, and have been timely with mortgage payments. Accordingly, CFI had no reason to believe that its management or ownership practices were anything less than satisfactory to HUD because it enjoyed the full support of the Department as HUD regularly endorsed CFI's activities, approved rent increases and accepted the audited financial statements filed with HUD.

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[1] 24 CFR Section 200.857(b)(i) (2007).

Similarly, the financial management of CFI has always been given a clean report by Certified Public Accounting firms with deep experience in auditing HUD properties.

On December 15, 2005, the HUD Jacksonville field office issued the results of a limited financial review of the four CFI residential properties. CFI agreed with some of the review findings, but took issue with a number of HUD's conclusions. The HUD review raised some issues of concern, which led the CFI Board of Directors to undertake its own independent review of Foundation operations. The Board concluded that some operational changes should be made. The Board made significant personnel changes, replaced identity of interest management at HUD's request, and worked to rebuild HUD's confidence in its stewardship of the properties. Acquiescence to the management change in 2006 alone came at a significant cost to CFI, which negatively impacted the other programs that it provides.

The CFI Board directed its staff to respond proactively and aggressively to the open concerns and was fully cooperating with HUD when the referral to the OIG occurred. The Board was confused by the referral because CFI and the Jacksonville office had developed a viable corrective action plan and were collectively well on their way towards resolution of all open issues. In fact, the local HUD management had already begun closing various items raised in its limited financial review as CFI made improvements and, in some cases, reimbursed funds to the projects where we agreed with the findings.

CFI values its long-standing relationship with HUD. However, we are disappointed in the unbalanced assessment of the Foundation's activities as depicted in the OIG draft audit report. The OIG has chosen to apply HUD guidelines in an unduly restrictive manner ignoring ambiguities and shortcomings in the policy documents themselves. Various HUD officials have admitted that some of the Department's guidelines are outdated and have not been revised to keep pace with significant changes in property management operations, including personnel issues and the realities of providing regional services across a number of properties, for example. In addition, there are a number of inaccuracies and misrepresentations within the draft audit report that we will address.

Perhaps most significantly, the unbalanced manner in which the OIG is choosing to interpret HUD's policies results in huge monetary demands that threaten the continuing existence of the Foundation and place the very housing that the residents depend upon at risk, as well as CFI's other charitable programs. All of this cannot be in the best interests of the vulnerable senior residents whom we serve. We trust that HUD shares our view. Preservation of these valuable assets should be HUD's focus, and not extinguishing the Foundation's mission of providing quality affordable housing to a vulnerable and needy segment of the population.

The OIG appears to have lost sight of the fact that CFI is an established, charitable faith-based nonprofit organization that consistently strives to place the best interest of its residents first. Over the years it has built and fostered close, caring communities that enhance the lives of their residents. The threatened loss of this housing and the host of

critical community services provided by the Foundation would be detrimental to the Jacksonville senior community and would do nothing to improve the health or condition of the well-managed residential properties.

In no way do I mean to imply that the OIG should not be looking at our record of compliance and reviewing the facts underlying our management, just as we should continue to perform our own analyses. But even the members of your staff with whom we have spoken acknowledge that there are many cases where handbook guidelines are unclear and subject to interpretation. It appears that the OIG often takes a harsh, punitive approach where judgments or interpretations of HUD's own guidelines are required. We are at a loss to understand why the OIG would choose this approach so often.

Finding 1: Alleged Mismanagement of Project Funds; Questioned Costs Total More Than $2.65 Million

Comment 1

The draft audit report makes many sweeping generalizations about the propriety of various Foundation expenses, and claims that such costs are unreasonable or unrelated to project operations. The Foundation disagrees with the majority of these claims.

In support of its allegations, the Department relies on various handbooks that it claims purport to prohibit the allegedly improper expenses. However, as you know, it is a well settled legal principle that such materials are guidance documents only, have not been promulgated through formal rulemaking procedures and do not follow the strictures of the Administrative Procedures Act,[2] and thus do not carry the force of law as a statute or regulation would.[3] Although such materials are entitled to a certain degree of deference, we are sure that you are aware that they are not the equivalent of regulations, exist to guide policy decisions generally, and may be bypassed without need for regulatory waiver.[4] In addition, as HUD and the OIG have admitted, there are a number of inconsistencies and conflicting terms within and between these materials that contribute to legitimate differences in interpretation and application. Accordingly, the OIG incorrectly states that CFI's activities necessarily violate regulatory provisions; no statutory or regulatory violations were cited.

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[2] 5 U.S.C. Sections, 552 and 553 (2007)

[3] *Thorpe v. Housing Authority of Durham*, 393 U.S. 268, 275 (1969) ("The various handbooks and booklets issued by HUD contain mere instructions, technical suggestions and items for consideration."); *Rousseau v. City of Philadelphia*, 589 F. Supp. 961, 971 (E.D. Pa. 1984) ("[t]he mere issuance of the Handbook by HUD does not necessarily raise its provisions to the level of a federal rule or regulation…. Handbooks that have not been published in accordance with the Administrative Procedures Act generally are considered to be non-binding instructions or internal operating procedures."); *Fiorentino v. United States*, 607 F.2d 963, 968 (Ct. Cl. 1979) ("It is unfortunately all too common for government manuals, handbooks, and in-house publications to contain statements that were not meant or are not wholly reliable.")

[4] *Reynolds v. United States*, 31 Fed. Cl. 335, 338 (1994) (discussing the limitations of the applicability of HUD Handbook 4350.1 because it had not been incorporated into the regulatory agreement).

Furthermore, we are troubled that the OIG appears set on stripping away project funds legitimately earned by the Foundation for what may amount to technical violations of HUD guidance materials. Even the Supreme Court has said in *Thorpe v. Housing Authority of Durham*, which is still good law, that HUD may not repudiate its obligations solely because of a failure to abide by instructions set forth in such materials even if such instructions were issued pursuant to HUD rulemaking authority.[5] In contrast, the HUD handbooks relied on by the OIG were not published in the Federal Register, and are to be accorded even less deference.

Comment 6

1A. Repayment of Owner Advances

The OIG maintains that CFI inappropriately used project funds to repay advances made to the properties by CFI without obtaining advance HUD approval and despite that the properties were not in a surplus cash position and carried outstanding flexible subsidy loans. CFI acknowledges that advances of funds to support reasonable and necessary project operations were made, but it disputes the OIG's calculation of the flow of funds into and out of the properties' operating accounts and the repayment amounts demanded.

All such advances were made to protect the interests of the residents and to enable project operations to continue without interruption or threat of interruption. Without these funding infusions from CFI, the properties likely would have been unable to make their mortgage payments, and would have been unable to achieve and maintain the high REAC scores consistently received. Simply put, the residents' lives were improved by the Foundation's advances. CFI was in no way enriched by this activity. The Foundation is confident that had advance approval been sought, HUD would have consented to and authorized the advances.

Presumably the HUD policy discouraging advances without HUD prior approval is intended to ensure that owners do not favor themselves over third parties to whom obligations are owed, or repay themselves when there are additional operating requirements of the properties. For example, if an owner advances $100,000 to a property which is not able at that time to repay the advance, and the property owes a third party $100,000, it makes sense for HUD to want to ensure that third parties are paid.

But this is not our situation. In our situation, property needs were handled quickly to ensure that third-party vendors were always paid on time, and when properties did not have sufficient funds to make such payments, CFI stepped in and advanced funds to make the payments, waiting to be reimbursed until rent or subsidy payments arrived on behalf of the particular properties. Thus, the Foundation engaged in activity that, but for the literal wording of the handbooks, HUD and the OIG, if it were considering the matter fresh, would praise.

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[5] 393 U.S. at 279 n.33.

Of course, in addition to looking at the treatment of third-party vendors, another question should be asked: were the projects hurt by this activity? Here all would agree that the projects were helped and not hurt.

And there is another factor that must be considered. The CFI advances made for the benefit of the residential properties and subsequent repayments must be analyzed in conjunction with CFI's HUD-approved inter-company cash management system where a bank utilized by CFI moved funds *automatically* between the Foundation's cash account and that of the residential properties'. All cash receipts were swept daily into the Foundation's cash account, and CFI in turn paid all of the bills on behalf of the residential properties.

There was never any intent to circumvent HUD accounting requirements. Instead, through this method there was the inadvertent "loaning" of CFI funds to the properties by way of the cash management system, and the subsequent unintentional "repayment" of such funds automatically when the properties happened to have positive cash flow. This is a very efficient and commonly used practice in business and can even be characterized as "common-sense" for the operation of multiple properties like CFI's.

In retrospect, perhaps, the cash management system should have been set up to guard against such automatic loans and repayments, but it was not that sophisticated, and the transfer activity was more a function of how the system was automatically administered by the bank. We note that this system was in place for seven years and did not raise any concerns for the auditors or HUD.

Further, and in addition to these general points, there are other problems with your analysis. For example, the OIG erroneously analyzed changes in monthly inter-company balances to arrive at the inflated repayment figure of $1,357,238. However, as HUD Handbook 4370.1 (Reviewing Annual and Monthly Financial Reports) provides, owner advances are assessed against annual or semi-annual surplus cash calculations; a review of monthly changes in the account balances produces an inaccurate assessment of the advance activity. The OIG's approach overstates the repayment demand because it does not account for monthly account variances caused by timing of vendor billings and payments or the timing of pass-through of certain charges (prepaid insurance, for example). Also, adjustments are normally made to various estimated charges in August or September each year in connection with closing the books for that fiscal year, and these can have an effect on the inter-company balances. Therefore, the only appropriate measure of the advance activity must be on an annualized basis.

HUD itself acknowledges that annual calculations are more appropriate and accurate because it bases its calculations of surplus cash on annual figures.[6] Accordingly, because HUD is relying on annual surplus cash analysis to determine if repayment is appropriate, it must likewise calculate the inter-company changes on an annual basis. When one

[6] HUD Handbook 4370.1, para. 2-21(f)(3)(a)

calculates the amount of the CFI repayments on an annual as opposed to a monthly basis, the amount in question decreases to $470,385.

Given the substantial benefits that the properties received as a result of CFI's contributions, it seems appropriate to credit CFI for the $332,980 it advanced to the properties. By netting advances against repayments, the potential amount that CFI may owe to the properties decreases to $137,405. Furthermore, when one looks at advance activity subsequent to the audit period, additional advances totaling $27,275 were provided to the properties, which further reduces the amount of the potential CFI repayment to $110,130.

Comment 1

Since CFI clearly did not benefit from, or become enriched by the "repayments" of its advances, and the residents were the exclusive beneficiaries of the CFI advances, the approach of netting advances against repayments is fair and reasonable. Because the HUD Handbook provisions were not promulgated pursuant to the Administrative Procedures Act, HUD policy regarding treatment of the CFI advances may be modified without resort to a formal regulatory waiver, and it is appropriate to do so in this instance.

It is undeniable that unless the calculation of the repayment demand is corrected to reflect annual figures and unless HUD modifies its policy with respect to prior approval of owner advances (all of which are within its authority), the OIG repayment demand in excess of $1.3 million dollars alone would be financially devastating and puts the residents at risk. It also seems totally at odds with common sense. This unfortunate result would not only fail to preserve valuable critically needed housing, but it would also cause great disruption in the elderly community and extinguish the host of other services that Jacksonville-area seniors depend upon from the Foundation. CFI acknowledges that a repayment of $110,130 may be appropriate.

Comment 7

1B. Challenged Salary and Fringe Benefit Costs

The OIG is demanding the return of $656,536 paid for salaries and fringe benefits for five employees that HUD claims were improperly charged to the residential properties. For the most part, the Foundation disputes the OIG's interpretation of whether the challenged personnel performed front-line activities and were therefore chargeable to the properties.

Administrator (aka Community Manager): $244,460

Business Office Manager (aka HUD Specialist): $116,445

Director of Facilities Operations (aka Maintenance Supervisor): $150,003

Director of Supportive Services: $84,706 (CFI will concede this position)

Administrative Secretary: $60,922 (CFI will concede this position)

The OIG is basing its decision on a claim that the positions are supervisory in nature, and reached this conclusion from its review of job descriptions and telephone calls with two CFI employees. In addition, an apparent lack of sufficient time records showing hours allocated between alleged supervisory functions and front-line duties factored into this determination. CFI takes issue with these conclusions.

Because of the proximity of the projects to one another (within one to two blocks), for efficiency, many tasks were split between them. These three positions, in effect the resident manager, the director of the residential office and the chief of maintenance, are clearly front-line positions.

The OIG's reliance on CFI's job titles as a measure of whether a given position entailed front-line or management agent duties is misguided. A more appropriate focus should be on the actual duties and essential functions performed rather than on the position descriptions themselves. As a nonprofit management agent, the Foundation could not afford the salaries paid by for-profit competitors, and had a tendency to inflate job titles and position descriptions as a form of compensation for its employees. We understand that this is a fairly common practice among non-profit providers.

The actual duties performed by the Administrator (aka Community Manager), the Business Office Manager (aka HUD Specialist) and the Director of Facilities Operations (aka Maintenance Supervisor) while CFI was management agent are virtually the same job functions as are currently performed under the third-party management agent, Jeffrey Charles, Inc. (JCI). We direct your attention to the attached comparison of job functions (Exhibit A). These job functions are currently paid for and carried by the properties as indicated in the HUD-approved budgets.

The OIG is demanding repayment of the entire salary of each employee as well as repayment for benefits paid for each disallowed position, although it cannot be denied that front-line services were provided by these employees for the benefit of the properties and the residents. Again, the OIG position seems at odds with common sense. This position is another example where judgment is called for, and the OIG has interpreted this in a way most prejudicial and onerous to CFI. This is an approach that is unfair and incongruous with the stated desires of the OIG to make this a fair review; this is an approach we cannot understand in light of the facts and information we provided.

The properties' high REAC scores and generally satisfactory management review ratings provide ample evidence of CFI's attention to the maintenance and caretaking of the properties. The OIG's demand is based solely on a lack of documentation of hours spent on project operations as compared to what the OIG believes to be management agent responsibilities. The fact that time sheets were not kept detailing the specific amount of time devoted to certain project functions cannot reasonably be said to invalidate these activities for the purposes of HUD's review.

HUD's position does not comport with the principles of fairness and equity federal courts have previously applied when reviewing claims for reimbursement in connection with a government contract. The properties, and by extension HUD because it provides the tenant subsidy, would be unjustly enriched if services provided by the CFI employees are accepted by HUD and yet the costs of providing those services are repudiated solely on the basis of a record keeping technicality articulated within a HUD guidance document.

In those cases where record keeping may not be in the ideal form that a federal agency may desire, federal courts have turned to other means of evaluating the services provided in order to ensure that proper remuneration is provided.[7] In these instances it is fitting to examine the practices of the present management agent that is overseeing the exact same properties.

We understand that the current management agent charges the total cost of the Community Manager, the Business Office Manager and the Director of Facility Operations positions back to the properties as these positions involve exclusively front-line activities. We understand that JCI also does not track hours spent on front-line versus management responsibilities as it believes that all of the activities performed by these individuals are front-line activities. This is the same practice that CFI followed, and yet the Department is applying different standards to CFI. Accordingly, the Foundation disputes the OIG's characterization of the $244,460 paid for the Administrator/Community Manager, the $150,003 paid for the Business Office Manager /HUD Expert, and the $116,445 paid for the Director of Facility Operations /Maintenance Supervisor as anything other than front-line positions that are properly chargeable to property operations. Repudiation of these salaries and benefits on the basis of a technical provision in a non-binding HUD Handbook would unjustly enrich the properties and, by extension, HUD.

With respect to the Administrative Secretary and the Director of Support Services positions, CFI will consent to repay the projects' residual receipts accounts for these two positions, totaling $145,628.

Comment 8

1C. Challenged Janitorial Costs

The OIG objected to the fees charged for janitorial services claiming deficiencies existed in the procurement process. The OIG substantially expanded the audit period for this issue to encompass an approximately six and a half year period in order to reflect bid activity from 1999 that predated the audit period. However, this bid information is dated and the proposed services were too different to be comparable. Accordingly, the Foundation disagrees with the methodology used by the OIG to calculate the $458,101 repayment request.

Due to the significant number of staffing changes implemented by the Foundation during the past 18 months, the OIG is well aware that institutional memory is lacking with respect to CFI activities dating back to the late 1990s. This does not mean that CFI's procurement practices are necessarily deficient; merely that certain gaps in the HUD-requested documentation appear to exist. The OIG should not automatically infer that something improper occurred because current CFI personnel have been unable to locate communications with bidders more than six years old.

A significant flaw in the OIG's analysis is the improper comparison of the 1999 divergent bids (which spanned quite a range of service proposals) and HUD's selection of a questionable bidder as the baseline against which to compare the CFI cleaning charges *regardless of the fact that the proposed services were not remotely comparable*. This effectively inflates the amount of the repayment demand to an artificially high level.

As has been previously explained and documented to the OIG, prior to 1999 there were two separate cleaning contracts in place serving the CFI properties. One contract covered janitorial services only, and a separate contract provided limited carpet cleaning services. At that time, carpets within the units were only cleaned upon unit turnover or upon the occurrence of a major event, such as a flood, or when extensive soiling required emergency cleaning services. Regular in-unit carpet cleaning was not provided.

Following a number of resident complaints about the janitorial contractor, meetings were held with this supplier, and attempts were made to obtain improved performance. We understand that janitorial services did not improve despite these efforts, and CFI decided to bid out the work to new suppliers. Also during 1999, CFI became dissatisfied with the quality of services provided by the carpet cleaning contractor and decided to add limited carpet cleaning (common areas) to the bid request. Five potential suppliers responded to the request for proposal, including a division of CFI.

At some point during this process, a decision was made to also add in-unit carpet cleaning services to the scope of the cleaning contract, with one third of the units scheduled to be cleaned each year. This feature was added in response to resident requests because a significant proportion of the units had not had their carpets cleaned in some time. CFI also determined that it would improve scheduling and minimize resident disruptions if all of these services were provided by a single supplier. Due to the aforementioned institutional memory problems, we cannot be certain whether the expanded scope of work, which now included in-unit carpet cleaning as well as janitorial and common area carpet services, was provided to the cleaning contract bidders and whether bidding was reopened. From the bid documentation examined, it appeared self-evident to the Foundation that only a single provider, CFI Environmental Services, a division of CFI, had the requisite capacity to meet all of these requirements.

There are a number of problems with the OIG's selection of the former janitorial contractor as the point of comparison for the cleaning contract charges. First, given CFI's negative experience with the unsatisfactory performance of this supplier, CFI

understandably did not select that provider, although its bid was lower. As HUD is aware, a low price is not the sole determinate of a qualified supplier. In addition to price, one must take into account the scope of services to be provided and the experience and reputation of the bidder.[8] Second, the incumbent janitorial supplier had only bid on janitorial and limited carpet cleaning services, whereas CFI Environmental Services was providing janitorial and comprehensive carpet cleaning services (both common area and in-unit cleaning). Thus the scope of services is vastly different and not comparable. Third, the 1999 bid data is extremely outdated and non-reflective of current costs.

Up until February 2007, the OIG itself acknowledged the shortcomings of working with the 1999 bid data. A more appropriate point of comparison, and one that actually reflects current practices, would be to compare CFI's cleaning charges against those incurred by the current management agent. This had been the analytical approach adopted by the OIG, and we do not know why the draft audit report departed so substantially from this framework. This approach appears to be another example of the OIG looking for a methodology to be more punitive and economically harmful for CFI, even to the extent of changing from the OIG field team's initial well thought-out methodology to a harsher one after the work was complete and being reviewed by superiors.

We understand that JCI has moved all cleaning operations in-house, and currently the cost of these services are approximately $10,000 per month to clean the residential properties. The OIG had previously determined that this was an appropriate basis for comparison because the same number of staff perform the cleaning operations, and essentially the same services are being provided. By netting the current management agent's cleaning charges against those charged by CFI, and making adjustments for inflation using the OIG's cost of living factors over the 6 year, 8 month audit period, a more appropriate and accurate calculation of cleaning fee overcharges to be returned to the properties is $289,287.

Another appropriate basis of comparison are the results of the March 2006 bidding conducted for comprehensive cleaning services to be provided at the CFI residential properties. The following offers were received as part of this process:

(Response continues on next page.)

Bidder	*Monthly Cost*	*Annual Cost*	*Comments*
Company A	$2,912	$34,944	Proposal was not submitted in the required format and was non-responsive.
Company B (former un-satisfactory janitorial contractor)	$8,967	$107,604	Initial proposal was non-responsive to all bid requirements. This company provided poor quality services to CFI in the past, and CFI lacks confidence in their capabilities.
Company C	$10,687	$128,244	Initial proposal was non-responsive to all bid requirements. Franchise operation.
Company D (CFI Environmental)	$14,427	$173,124	
Company E	$21,345	$256,138	Deemed most responsive bidder by CFI's Director of Operations
Company F	$25,916	$310,986	

As the chart illustrates, CFI Environmental was a mid-cost bidder. Nevertheless, CFI's Director of Operations at the residential properties (prior to cessation of management operations), believed Company E's bid to be the most responsive in terms of the comprehensive nature of the services to be provided despite that this bid was more costly. The 2006 bid process confirmed that CFI Environmental's costs were commercially reasonable.

Ruling out the non-responsive bidder (Company A) and the former janitorial contractor for performance deficiencies (Company B), the least cost bidder that conformed to all bid requirements (following revision of its original proposal)[9] was Company C.[10] After adjusting for inflation using the OIG's cost of living factors and netting Company C's annual costs against the CFI charges incurred over the audit period, the amount of the CFI repayment would be $238,685. We have attached a spreadsheet detailing the methodology used to arrive at these calculations for your review (Exhibit B).

CFI provided adequate cleaning services as evidenced by the consistently high REAC scores at all four properties. Although the 1999 bid process could have been undertaken in a more systematic fashion and a portion of the relevant procurement documentation cannot be located due to personnel changes, CFI maintains that sufficient services were

[9] Companies A, B and C were invited to revise their bids because they had omitted a service required by the scope of work. Only B and C responded with revised bids.
[10] The Foundation elected not to select this bidder, however, because it was a franchise operation, and CFI had not received appropriate assurances regarding which individuals would be providing the proposed cleaning services.

provided for a commercially reasonable price. The OIG's basis of comparison, which uses a low bidder of questionable capability, is improper and must be set aside. A more appropriate calculation should be based on a comparison of fees currently charged by the independent management agent or a comparison based on the results of the March 2006 bid process.

Comment 9

1D. Challenged Retirement Plan Costs

The OIG claims that certain unnamed employees of CFI cannot be determined to be full-time equivalents for purposes of qualifying for retirement plan benefits because CFI did not maintain time records of hours worked at each property. As has been explained to the OIG at great length, due to the size and close proximity of the properties to one another (located within one to two blocks of each other), CFI had a practice of rotating employees between the sites as this was the only economically feasible means of staffing the properties. This is similar to the staffing practices currently employed at the properties under the new agent.

OIG's claim that all such employees' contributions to the CFI retirement plan (totaling $115,372) are ineligible project expenses solely because of a lack of time records is an attempt by HUD to repudiate its obligations because of an alleged failure to abide by the technical requirements of a non-binding HUD handbook.[11] This is another example of where the OIG is following form over substance, and in the process would unjustly enrich the properties and itself at the expense of the Foundation. In fact, despite CFI not having records to show that the individual employees in question worked at least 20 hours per week at any of the properties, in meetings with the OIG audit team, the team leader explicitly acknowledged that *all of the employees in question worked full time for the properties.* To reverse position and to deny these full time employees retirement plan contributions defies common sense, the intent of the program requirements, and good management practices.

As stated in our response to item 1B, we understand that JCI deems all of the duties performed by the Community Manager (formerly Administrator), HUD Specialist (formerly Business Office Manager) and Maintenance Supervisor (formerly Director of Facility Operations) to be front-line responsibilities, and charges the full cost of these employees to the properties. Accordingly, JCI does not track the time spent on front-line versus management agent duties for these positions because all of the duties performed are front-line duties.

JCI allocates the costs of the front-line employees to the properties by virtue of a formula which reflects the occupancy percentages in each building. This is similar to the approach that CFI utilized, and one that we understand is fairly common in the industry, hence the employee apportionments are virtually the same:

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[11] *Thorpe*, 393 U.S. at 279 n.33.

	Cathedral Towers	Cathedral Townhouse	Cathedral Terrace	Cathedral Court
Jeffrey Charles Inc.	.32	.28	.38	.02
Cathedral Foundation	.28	.31	.38	.03

In addition, the essential job functions for each of the front-line positions have remained basically the same. We direct your attention to the attached comparison of job functions and associated duties, and the similarities cannot be missed (Exhibit A). These analyses confirm that CFI's staffing approach was both reasonable and appropriate. Accordingly, the OIG's attempt to disallow all employees' contributions to the retirement plans because of allegedly deficient time records should not be allowed to stand, especially since the third-party agent managing the exact same properties allocates personnel according to virtually the same apportionment methodology employed by CFI.

1E. Over-Accrual of Retirement Plan Cost

In March of 2007, CFI self-reported to the OIG a recent discovery that accruals of retirement costs, which are based on budget estimates, had not been reconciled and adjusted to reflect actual costs. In all, a total of $26,306 had inadvertently been overcharged to the properties. CFI has agreed to refund the amounts due to the appropriate properties.

Comment 10

1F. Charges for Employee and Guest Parking

Contrary to the OIG's allegations, the Foundation has provided a sizable amount of documentation to the auditors as justification for the parking fees charged for employee and guest parking at the residential facilities. Although HUD has a tendency to disfavor and view with skepticism identity of interest contracting arrangements, so long as the terms of the service delivery are commercially reasonable and no mark up is charged (facts that CFI has demonstrated), HUD lacks the grounds to question the fees charged.

As previously disclosed to the OIG, a survey of surface parking fees at nearby lots revealed that CFI's monthly charge of $40 per parking space was well below the current going rate for downtown locations, and was commercially reasonable. We understand that current management agent JCI has received approval to charge the properties $50 per space for resident and guest parking needs.

The lack of an actual contract, invoice or lease agreement with CFI is not unusual where one division of an entity performs a service for another division. Although there was no contract or lease with CFI, the monthly journal entries showed that commercially reasonable charges were assessed for the parking services provided. HUD Handbook 4370.2 provides that "other supporting documentation" besides invoices is an acceptable means of demonstrating the existence of a contracting relationship and as justification for

making disbursements from the regular operating account.[12] Based on the reasonable nature of the fees assessed, the need for the parking driven by the three high-rise buildings, and the journal entries that clearly tracked this relationship, we believe these fees are permissible.

Missing from the OIG's draft report is an analysis of the need for employee and guest parking, which was driven by tenant demand for on-site parking. Due to a lack of available on-site parking spaces, made especially acute by the mobility impairments of the residents and their need for parking spaces in close proximity to the buildings, CFI had no choice but to arrange to provide necessary parking spaces off-site. Prior to purchasing the off-site parking lot in 2001, the Foundation leased spaces from the former owner. By purchasing the lot, the Foundation was able to control development in the area and also to ensure that adequate parking spaces were available for the benefit of the residential properties. The Foundation performed a detailed analysis of the parking needs of its residents, employees and caretakers who regularly visited the properties to provide services to the residents, and provided this information to the OIG (Exhibit C). The analysis confirmed that the need and demand for this parking persists. We fail to see how OIG may conclude on the basis of all this information that the parking fees in question are "unsupported".

Furthermore, HUD consented to the employee parking charges as evidenced by its approval of CFI's Management Entity Profile (Exhibit D), which stated that CFI Parking was to provide parking services for employees. Therefore, CFI had reason to believe that HUD consented to this arrangement and that the fees charged were reasonable and necessary for project operations.

1G. Other Questioned Costs

OIG claims that CFI used project funds to reimburse disallowed management agent supervisory personnel for training and travel expenses. Although CFI believes that these costs are necessary and proper, it is willing to concede this point.

Comment 11

Finding 2: Unauthorized Collection and Retention of Resident Parking Fees:

In support of its claim that HUD does not allow owners of subsidized projects to charge tenants for residential parking, the OIG cites to HUD Handbook 4350.1, REV-1, the Multifamily Asset Management and Project Servicing Handbook. This is a misreading of the Handbook provision. Chapter 7, section 7-42 governing charges for facilities and services does not say that parking may not be charged at subsidized properties. If this were the case, then the standard HUD Model Lease would be in violation of the handbook.

[12] HUD Handbook 4370.2 REV-1 CHG-1, Chapter 2, Section 2.6(E).

Section 7-42 sets forth five points that must be met before owners may charge tenants for other services or facilities, including parking. Section 7-42(B)(5) has long been read to apply to both subsidized and unsubsidized properties despite that it states that "owners can charge for parking only in unsubsidized projects where HUD previously approved it." Given that the HUD Model Lease is an extensively vetted document, both inside and outside of the Department, and specifically provides for tenant parking fees, a more likely scenario is the drafters of this handbook provision mistakenly left subsidized properties out of this discussion. These inconsistencies are another example of the inherent weaknesses in the guidance documents themselves as well as the discordance between them.

Assuming for the sake of argument that subsidized properties are affected by the provisions of Section 7-42(B), we believe that CFI has satisfied each of the five provisions set forth therein: the charges are included on the most recently approved rent schedule, a schedule of charges was posted or distributed to the residents, use of the parking services was strictly optional, the charges were previously authorized by HUD, and HUD approval is evidenced in the rent schedules (Exhibit E). Therefore, the Foundation's practice of charging residents for parking is proper.

CFI believes that resident parking is an important service that the residents value. We have been told as much by our residents. Parking fees are discernable from late fees, which are non-recurring and punitive in nature. Although late fees have been specifically disallowed at elderly properties since May 24, 2005,[13] parking fees are distinguishable from late fees and are permitted so long as the five criteria are met, which CFI has demonstrated that it satisfied.

Conclusion

Comment 1

While the Foundation is willing to admit that in the past certain mistakes were made in operations and oversight at senior levels could have been improved, it is simply inaccurate for the OIG to represent that project operations have been compromised by fund diversions on the scale alleged. Quite frankly, the OIG has seriously miscalculated expenses and fund movements, and has inferred diversions of funds that did not occur in the vast majority of circumstances. Furthermore, the OIG has consistently interpreted non-binding HUD Handbook applications in the most restrictive manner possible, to the detriment of CFI.

CFI calculates that had the OIG adopted more appropriate cost comparisons and accurately calculated the overages legitimately payable to the properties, the total amount that the Foundation may legitimately be claimed to owe is $527,100. While CFI does not

[13] This is the date of a memorandum issued by former Deputy Assistant Secretary for Multifamily Housing Programs, Stillman D. Knight, clarifying certain provisions of HUD Handbook 4350.3, the HUD Occupancy Handbook.

Comment 12

admit to owing even this amount, it is willing to pay this sum to the projects from non-project sources in order to settle these findings. We offer this at the expense of other CFI actions and programs, where we in fact believe the money would be better spent. While CFI regrets that any mistakes were made at all, it is willing to take responsibility for its actions, but it strongly objects to the assertion that its activities compromised project activities and put the properties at risk. To the contrary, without the active involvement of the many dedicated employees of CFI and its financial contributions to the properties, it is likely that the properties and residents would have suffered. As it stands, the properties are currently in excellent physical condition and have adequate resources to meet project demands.

Comment 4

In response to the OIG's draft recommendation that the Departmental Enforcement Center pursue appropriate administrative enforcement action against the Foundation and the project owners for alleged non-compliance, we do not agree that heaping additional sanctions on CFI would serve HUD's purpose. Adding penalties to an already contrite charitable organization that has been and remains fully cooperative with HUD, and has not knowingly or materially violated the HUD guidelines serves no function that we are aware of. As we have already made clear, none of the properties or the residents have been harmed, the government's interests have not been hampered, and no one has been enriched by the technical departures from HUD programmatic guidance. In order to prevail in such an administrative proceeding, HUD would have to establish a number of facts, including whether violations of the HUD guidelines were knowing and material, whether the government was harmed, and whether the owners received any benefit, which they have not. We do not believe the government would meet its burden.

We would like to remind the Inspector General of the very real impact that these findings and their associated repayment demands threaten to have on the 637 resident households who call the CFI properties home. The OIG's demands would be financially devastating and thereby extinguish CFI's mission and ability to provide quality affordable housing to a vulnerable segment of the Jacksonville population. Continuity and stability are incredibly important to the elderly population, and anything that may threaten or disrupt this environment would be detrimental to the residents. Never has there been an allegation that CFI has done anything except provide excellent service and accommodation to residents in our community, nor have we ever heard that the community has been anything but well served by the Foundation's mission to its constituents in partnership with HUD.

To mortally wound CFI and render it unable to continue in the productive partnership it has enjoyed with HUD due to overly zealous application of administrative guidelines would be a tragedy and travesty. We know that all departments of HUD and all of its employees share the goal and mission of taking care of constituents in a manner that wisely uses precious taxpayer dollars, and we believe that the entire record of CFI's performance, and the record of HUD corroboration of that record through years of positive management and operations review ratings, high REAC scores, and acceptance of financial reports and audits is clear. The Foundation has always been willing to

improve its operations, and has always responded positively and proactively when HUD has made suggestions or when findings or mistakes were brought to its attention, and it has gone so far as to refund monies that HUD has disputed. Therefore, we urge the Inspector General to take these factors into consideration and reconsider the recommendations contained in the draft audit report.

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OIG Evaluation of Auditee Comments

Comment 1 The Foundation stated the OIG placed an improper reliance on literal interpretations of HUD guidance material designed to shape HUD oversight and does not enjoy the force of law. The Foundation maintained that the HUD guidance was not designed to burden property management with requirements that fly in the face of efficient operations and generally accepted approaches.

The Foundation's position disregards the fact it agreed contractually to be bound by HUD regulations and handbooks when it executed various project owner/borrower certifications. Paragraph 3 of the project owner's certifications for the four projects provides that the owner/management agent agrees to comply with the regulatory agreement and with HUD handbooks, notices and other policy directives that relate to the management of the projects.

The Foundation and project owners had no authority to disregard HUD guidance covered by the above certifications that they disagreed with or which they feel does not enjoy the force of law. The Foundation and project owners are responsible for the impact the violations had on their operations and mission. Generally, the Foundation and owner did not follow requirements they either knew or should have known.

Comment 2 We address these comments where they are discussed in more detail on the following pages.

Comment 3 The Foundation requested that we revise the report because it contains many erroneous conclusions. The Foundation provided no new information at the exit conference or in its written response that warranted revision to the draft report.

Comment 4 Contrary to the Foundation's position, the violations warrant consideration by the Departmental Enforcement Center.

Comment 5 The Foundation will need to work with HUD on resolution of the audit recommendation and determination of the amounts to be repaid. As explained during the exit conference, HUD will review the recommendations and consider additional information from the Foundation and project owners before deciding the final amount they should reimburse to the four projects.

Comment 6 The Foundation disagreed with the method we used to calculate the $1.35 million it repaid itself for advances. The Foundation claimed the advances prevented mortgage default and that repayment of advances should be based on the net inter-company changes on an annual basis.

HUD's approval is not required for owners to make advances. In fact, HUD encourages such advances when needed to help projects to meet their operating obligations. HUD has always required prior approval for owners to use project

funds to repay advances. Handbook 4370.1, paragraph 2.21(F)(3), requires owners to obtain prior HUD approval before repaying project advances on a monthly basis or at the end of semi-annual or annual periods used to determine surplus cash.

We tracked the flow of funds through the projects and Foundation general ledgers and identified each instance where the Foundation repaid itself for advances without HUD approval. Furthermore, the need for advances may have been eliminated or reduced if the Foundation had not charged the projects more than $1.1 million for costs related to its operations and for costs that were excessive or unnecessary.

Comment 7 The Foundation maintains that only $145,268 of the reported $656,536 should be disallowed. We reviewed the Foundation's response and supporting exhibits and found no time records or other support for their position that the costs were for front line staff allowed to be charged as project cost. Therefore, we did not revise our conclusion. The Foundation commented that the projects' new management agent charged similar costs to the projects. The requirements cited for the Foundation also apply to the new management agent.

Comment 8 The Foundation believes the $460,000 questioned janitorial cost is too high and that it resulted from a flawed and aggressive methodology for a timeframe that went beyond the audit period. The Foundation maintained that the 1999 bid data we used is dated and the proposed services were too different to be comparable.

During the course of the audit, we discussed and considered several different means to assess the reasonableness of the janitorial cost. We decided to use the 1999 bids with an adjustment for inflation, because that was the time period the Foundation decided to do the janitorial work itself.

The Foundation provided no documentation to support its comments it was the only bidder with the capacity to do the work and to justify awarding the work to itself although it was not the lowest bidder. The 1999 bid proposal consolidated cleaning work that was previously fragmented between different vendors. After obtaining the bids, the Foundation changed the scope of services and awarded the work to itself with no evidence that other bidders were given an opportunity to review the revised scope of work and to revise their bids. The Foundation did not execute or provide a contract with itself to show the scope of work.

Contrary to the Foundation's claim, the 1999 bids along with our adjustments for inflation provide a conservative estimate of the excessive janitorial cost. The questioned cost would have been more if we had used the two other lower bid amounts.

Comment 9 The Foundation disagreed with the conclusion that retirement plan costs were not allowable.

We acknowledged that the affected staff worked for multiple projects, but they did not work full time for any one project. HUD requires workers to be employed fulltime at one project to qualify for retirement benefits. The Foundation stated that the new management agent practices were basically the same as those the Foundation followed. The requirements cited for the Foundation also apply to costs incurred by the new management agent.

Comment 10 The Foundation disagreed with our recommendation to support or reimburse the projects for employee and guest parking fees. The Foundation stated the parking fee was reasonable and that the new management agent made similar charges for parking.

We did not question whether the amount paid for the parking fee was reasonable. We questioned the cost because the Foundation did not provide or execute a contract with the projects for the cost and did not maintain documentation to show how much of the cost was for guest parking. HUD subsequently allowed the new management agent to charge the projects for two guests parking slots but not for employee parking. HUD received a copy of the information the Foundation provided in the attachment to its response and will consider it when they assess whether to allow the cost. The requirements cited for the Foundation also apply to the new management agent.

The Foundation's Management Entity Profile identified employee parking as an identity of interest service provided to the projects. The disclosures on that form did not relieve the Foundation of its responsibility to properly support parking charges subsequently paid from project funds.

Comment 11 The Foundation disagreed with our recommendation that they reimburse subsidized tenants for the parking fees they paid. The Foundation claimed that we misread the handbook requirements that they interpret to allow the questioned parking fees.

The handbook does not allow tenants of subsidized projects to be charged a fee for parking. HUD's approval of the rental schedules does not supercede the requirement.

Comment 12 The Foundation maintains that its activities did not compromise the projects and put them at risk.

As cited in the report, the questioned costs adversely impacted the four projects ability to generate surplus cash needed to fund residual receipts and for three projects to repay flexible subsidy loans. The questioned costs also benefited the Foundation because it used project funds to pay Foundation costs it should have paid from the management fees it collected from the projects.