



**Madison Park North Apartments  
Baltimore, MD**

**Section 236 Multifamily Program**



Issue Date: April 19, 2013

Audit Report Number: 2013-PH-1003

TO: Mary Ann Henderson, Director, Baltimore Multifamily Hub, 3BHMLAS  
//signed//  
FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA  
SUBJECT: Madison Park North Apartments Generally Ensured That Procurement and Reserve for Replacement Requirements Were Met

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Madison Park North Apartments, Baltimore, MD.

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

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

If you have any questions or comments about this report, please do not hesitate to call me at 215-430-6729.



April 19, 2013

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## **Madison Park North Apartments Generally Ensured That Procurement and Reserve for Replacement Requirements Were Met**

# **Highlights**

Audit Report 2013-PH-1003

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

We audited the procurement process of Madison Park North Apartments, a Section 236 property, at the request of the Director of the U.S. Department of Housing and Urban Development's (HUD) Baltimore Office of Multifamily Housing Programs. We also reviewed Madison Park's use of its reserve for replacement account. Our objective was to determine whether Section 236 procurement and reserve for replacement account requirements were met.

### **What We Found**

Madison Park generally ensured that procurement and reserve for replacement account requirements were met. However, it did not obtain cost estimates from three contractors, as required, for \$168,702 in repairs of housing units.

### **What We Recommend**

We recommend that the Director of HUD's Baltimore Office of Multifamily Housing Programs require Madison Park to implement and follow adequate controls to ensure that it obtains three cost estimates for services that exceed \$10,000 per year.

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## **BACKGROUND AND OBJECTIVE**

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The Madison Park North Apartments are located at 738 West North Avenue, Baltimore, MD. The project is owned by Madison Park North Limited Partnership, and its management agent is Tricap Management, Incorporated. The apartment complex has 202 housing units.

The U.S. Department of Housing and Urban Development (HUD) entered into a regulatory agreement with Madison Park in 1985 for its Section 236-insured multifamily program. The program, established by the Housing and Urban Development Act of 1968, combined Federal mortgage insurance with interest reduction payments to the lender for the production of low-cost rental housing. Under this program, HUD provided interest subsidies to lower a project's mortgage interest rate to as low as 1 percent. This program no longer provides insurance or subsidies for new mortgage loans, but existing Section 236 properties continue to operate under the program. The interest reduction payment results in lower operating costs and, thus, a reduced rent structure. Additionally, the project executed a housing assistance payments contract with HUD.

Between fiscal years 2008 and 2012, the project received \$1 million in interest reduction payments and \$8.3 million in housing assistance payments.

Our audit objective was to determine whether Section 236 procurement and reserve for replacement account requirements were met.

## RESULTS OF AUDIT

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### Finding: Madison Park Generally Ensured That Procurement and Reserve for Replacement Account Requirements Were Met

Madison Park generally ensured that procurement and reserve for replacement account requirements were met; however, it did not obtain written or verbal cost estimates for the repair of its housing units. It paid one contractor without obtaining written cost estimates from at least three contractors as required. This condition occurred because Madison Park did not expect to pay the selected contractor more than \$10,000 per year. As a result, the project paid at least \$168,702 without adequate support to show whether the services were provided at a reasonable cost.

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#### **Cost Estimates Were Not Obtained as Required**

Of the \$2.9 million paid to nine contractors, Madison Park was unable to provide documentation showing that it obtained cost estimates for \$168,702 paid for the repair of housing units. It paid one vendor yearly labor costs ranging from \$21,958 to \$92,369 for the repair of its housing units. HUD Handbook 4381.5, paragraph 6.50, states that the owner is to obtain written cost estimates from at least three contractors for services that exceed \$10,000 per year. Although Madison Park did not obtain cost estimates for services rendered, it did maintain invoices, work order proposals, and copies of checks that adequately supported the repair cost paid.

#### **Madison Park Established, Maintained, and Expended Its Reserve for Replacement Account as Required**

Madison Park established and maintained a reserve for replacement account as required. Section 2(a) of its regulatory agreement required that a reserve for replacement account be established and maintained. Madison Park maintained documentation to support that it had established a reserve for replacement and made the monthly deposits as required. The documentation adequately supported Madison Park's efforts.

Madison Park also expended reserve for replacement account funds as required. Section 2(a) of its regulatory agreement and HUD Handbook 4350.1, REV-1, paragraph 4-15(A), required that the project obtain HUD's approval to withdraw

from the account. Madison Park maintained documentation, such as HUD-approved funds authorization forms, certifications, and other documentation, to demonstrate its compliance with this requirement.

### **Repair Costs Were Paid on a Case-by-Case Basis**

Madison Park stated that it did not obtain cost estimates because it paid the selected contractor on a case-by-case basis. Although the majority of the repairs were less than \$5,000 each, the yearly costs exceeded \$10,000. The yearly costs paid to the contractor over a 3-year period ranged from \$21,958 to \$92,369. Based on the costs paid in 2009, Madison Park should have planned accordingly to ensure that cost estimates were obtained from three contractors since there was a pattern established which showed that the repair cost would exceed \$10,000 per year.

When we informed Madison Park about this deficiency, it implemented additional controls to ensure that it obtains cost estimates from three contractors as required. Madison Park now obtains three cost estimates for each repair needed for a housing unit to ensure that the procurement requirements are met.

### **Conclusion**

The project did not always obtain cost estimates as required. As a result, it paid at least \$168,702 to one contractor without adequate support showing that services were obtained at a reasonable cost. However, since it appeared that the prices paid were reasonable, we did not recommend that the project be required to demonstrate the reasonableness of the cost to HUD. However, we do recommend that the project implement and follow adequate controls to ensure that it obtains three cost estimates for services that exceed \$10,000 per year.

### **Recommendations**

We recommend that the Director of HUD's Baltimore Office of Multifamily Housing Programs direct Madison Park to

- 1A. Implement and follow adequate controls to ensure that it obtains three cost estimates for goods or services that exceed \$10,000 per year.

## SCOPE AND METHODOLOGY

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We conducted the audit from July 2012 to March 2013 at Madison Park's office located at 738 West North Avenue, Baltimore, MD, and at our offices located in Pittsburgh, PA, and Baltimore, MD. The audit covered the period April 2008 through September 2012.

To achieve our audit objective, we reviewed

- Applicable HUD guidance at 24 CFR (Code of Federal Regulations) Part 236 and other directives that govern the program.
- Madison Park's regulatory agreement, audited financial statements, and other program records.
- A nonstatistical sample of \$2.9 million awarded to nine contractors during the audit period. We reviewed the procurement files of the costs paid.
- Reserve for replacement account documentation including Madison Park's requests and certifications and HUD's approval to release the funds.

We conducted interviews with responsible employees of Madison Park, its management agent, and responsible HUD staff. We reviewed the procurement files for goods and services totaling \$2.9 million. We reviewed invoices, checks, and other documentation to determine whether procurement requirements were followed. We also reviewed documentation related to the use of the reserve for replacement account.

To achieve our audit objective, we relied in part on computer-processed data. The data included Madison Park's expenditures, procurement records, and other computer-generated data. Although we did not perform a detailed assessment of the reliability of the data, we did perform a minimal level of testing and found the data to be adequate for our purposes.

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

# INTERNAL CONTROLS

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

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

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

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## Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that the program meets its objectives.

We assessed the relevant control identified above.

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

We evaluated internal controls related to the audit objective in accordance with generally accepted auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of Madison Park's internal control.

# APPENDIX

## Appendix A

### AUDITEE COMMENTS AND OIG'S EVALUATION

**Tobin  
O'Connor  
& Ewing**

*Practicality in Practice*

Attorneys at Law  
*A Partnership of Professional Corporations*

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April 12, 2013

Via E-Mail and Regular Mail

John Buck  
U.S. Department of Housing and Urban Development  
Regional Inspector General for Audit  
Wanamaker Building  
100 Penn Square East, Suite 10205  
Philadelphia, PA 19107-3380

Re: Response to Draft Audit Report re Madison Park North Apartments,  
Baltimore, MD

Dear Mr. Buck:

This response to the draft audit report regarding Madison Park North Apartments' Section 236 Procurement and Reserve for Replacement Account Requirements is submitted on behalf of the owner and management of Madison Park North Apartments.

As we noted during the exit conference, we appreciated the OIG staff's courteousness and professionalism during the audit. We also appreciated the many opportunities that we were given in the course of the audit to submit information for review.

While we generally agree with the finding and recommendation, there are two clarifications that we would like to provide, and there are two revisions that we request be made in the final audit report.

**Clarifications**

Our clarifications are as follows:

First, we note that the audit finding is based upon a HUD Handbook, not a statute or a regulation. The Handbook provision at issue does not specifically require three cost estimates for contracts over \$10,000.00; instead, it states that a management agent is "expected" to obtain the cost estimates. (HUD Management Agent Handbook, 4381.5, Section 6.50.) The underlying

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Comment 3

regulatory agreement requirement is that "[p]ayment 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 supplies or materials furnished." (Tab 4, Paragraph 8.) While obtaining three cost estimates might provide a "safe harbor" for reasonableness, that is not to say that contract costs are unreasonable just because three cost estimates may not have been not obtained and/or retained in the files.

Comment 4

Second, with respect to the questioned \$168,702, we note that this finding is based upon the OIG's conclusion that – because of the property's past payments to this particular vendor – the owner should have "expected" that payments to the vendor in one year would be over \$10,000. It is not clear to us how the Handbook provision should be applied in the context of work being done on a job-by-job basis, as was the case with this vendor. Just because recent payments were over \$10,000 per year to this vendor, that does not automatically mean that going forward, similar payments should be "expected," because the owner/management could have decided to stop using this vendor at any point. Indeed, the draft audit itself states that the condition occurred because Madison Park "did not expect" to pay more than \$10,000. (Page 4.)

**Requested Revisions**

As discussed during the exit conference, we request that two revisions be made to the draft audit report:

Comment 5

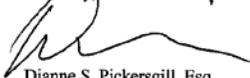
First, we request that the recommendation be revised to say: "implement adequate controls." This is the language that was contained in the finding outline that we were provided; it is the language on page 1 of the draft audit report; and it is consistent with the format of recommendations in other OIG audits where auditees are required implement procedures to address a finding. As pointed out in the draft audit report, the auditee has already put in place enhanced controls.

Comment 6

Second, we request that the issue listed as a significant deficiency under "Internal Controls" be removed. In the context of the overall scope of the audit, the issue should not be considered significant, and we request that it be addressed in a separate letter to the auditee instead of in the audit report itself.

Please let us know if you have any questions.

Sincerely,



Dianne S. Pickersgill, Esq.

cc: Kimberly Harrison (via e-mail)  
Chandra Dey (via e-mail)

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## OIG Evaluation of Auditee Comments

- Comment 1** We are pleased that Madison Park generally agrees with the finding and recommendation in the audit report.
- Comment 2** The audit finding is based upon HUD Handbook 4381.5, which states that a management agent is expected to obtain cost estimates. The guidance in the handbook applies to management agents of HUD-insured properties. Additionally, the management agent certified that it would comply with HUD handbooks and obtain verbal or written cost estimates. Thus, the cost estimates should have been obtained to ensure compliance with the Section 236 program requirements.
- Comment 3** We agree that obtaining three cost estimates provides a safe harbor for reasonableness of cost.
- Comment 4** Madison Park paid \$168,702 to one contractor without obtaining cost estimates as required. The services were provided over a 3-year period in which yearly cost ranged from \$21,958 to \$92,369. Due to the fact that the cost paid for the repair of its housing units exceeded the previous year's repair costs, Madison Park should have obtained costs estimates to ensure compliance with Section 236 requirements. HUD Handbook 4381.5, paragraph 6.50, required that the owner obtain written cost estimates from at least three contractors for services that exceed \$10,000 per year.
- Comment 5** The recommendation to implement and follow controls is appropriate and should help ensure future compliance.
- Comment 6** We revised the internal control section of the report to state that our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of Madison Park's internal control.