Issue Date November 4, 2009	
Audit Report Number 2010-NY-1003	

TO: Teresa Bainton, Director, Office of Multifamily Housing, New York 2AHMLAP

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, New York/New Jersey Region, 2AGA

SUBJECT: The South Bronx Community Management Co., Inc., Bronx, New York Had Weaknesses in Its Administration of the Project Maria Isabel

HIGHLIGHTS

What We Audited and Why

We reviewed the management agent operations of the South Bronx Community Management Co., Inc. (agent), as they relate to the administration of the U.S. Department of Housing and Urban Development (HUD)-Section 202 direct loan for elderly and handicapped housing project Maria Isabel (project number 012-EH-473) at the request of the HUD New York City Office of Multifamily Housing. HUD officials were concerned about the management of the project. The objective of the review was to determine whether the agent complied with HUD's financial and unit maintenance standards regulations in its management of the project Maria Isabel.

What We Found

The agent generally complied with HUD financial and unit maintenance standards regulations in its administration of the project. However, various issues warrant HUD's attention to provide greater assurance that the project is managed in the most economical and efficient manner. Specifically, (1) tenant accounts receivable and vendor accounts payable were not properly reported, (2) prudent procurement practices were not always followed, (3) advances were made by and partially repaid to the agent without HUD approval, and (4) action to mitigate cash-flow problems was not addressed in a timely manner, but has since been taken. As a result, HUD was not made aware of the financial condition of the project, and the project experienced serious cash-flow problems.

What We Recommend

We recommend that the Director of HUD's New York Office of Multifamily Housing instruct the agent and property owners to

- Determine the collectability of delinquent tenant accounts receivable and request HUD approval to write off those accounts determined to be uncollectible,
- Strengthen procedures to ensure accurate reporting of accounts payable,
- Establish procedures to request approval for receiving and paying agent advances,
- Strengthen procedures to provide greater compliance with HUD's and its own procurement procedures, and
- Strengthen controls to ensure that late fees are minimized and that actions to mitigate cash-flow problems are addressed in a timely manner.

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 discussed the contents of this report with the auditee during the audit and provided it with a copy of the draft report on October 9, 2009. We held an exit conference and received the auditee's written comments on October 20, 2009. The auditee agreed with our findings and has taken action to address the recommendations made.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

Maria Isabel (project number 012-EH-473) is a 99-unit Section 202 elderly and handicapped project that received a U.S. Department of Housing and Urban Development (HUD) direct loan for construction. The project is owned by the Maria Isabel HDFC, Inc. (Housing Development Fund Corporation, Inc.), and the owner is overseen by a three member board of directors.

Maria Isabel was approved on April 10, 1987, under Section 202 of the Housing Act of 1959 for a $7 million loan to construct an elderly housing and began renting to tenants in 1988. During the 12-month period ending June 30, 2008, the most recent period for which certified financial statements have been issued, Maria Isabel received housing assistance payments of $1.1 million and reported a negative surplus cash position of $558,207. In its most recent HUD physical inspection, conducted in June 2009, it received a passing score of 80.

Property owners are ultimately responsible for ensuring that HUD-subsidized properties are operated in an effective and efficient manner. Thus, the regulatory agreement between the project owner and HUD specifies that the responsibilities of the project owner are to maintain the project and its records in accordance with HUD requirements. However, property owners may contract with a management agent through a management agreement to oversee the day-to-day operations of the property and maintain the financial and accounting records. The management agent executes a management certification providing that it will comply with the property's regulatory agreement and other HUD requirements. The South Bronx Community Management Co., Inc. (agent), serves as the management agent.

The owner and the agent executed a project owner's/management agent's certification in April 2004, in which the agent agreed to, among other things,

- Ensure that all expenses of the project are reasonable and necessary;
- Exert reasonable effort to maximize project income and to take advantage of discounts, rebates, and similar money-saving techniques;
- Obtain contracts, materials, supplies, and services, including the preparation of the annual audit, on terms most advantageous to the project; and
- Obtain the necessary verbal or written cost estimates and document the reasons for accepting other than the lowest bid.

Under the terms of the certification, which automatically renews annually, the agent is entitled to a management fee of 4.25 percent of residential income collected.

The objective of the review was to determine whether the agent complied with HUD's financial and unit maintenance standards regulations in its management of the project Maria Isabel.

RESULTS OF AUDIT

Finding 1: The Agent's Administration of the Project Maria Isabel Had Weaknesses

The agent generally complied with HUD financial and unit maintenance standards regulations in its administration of the project. However, various issues warrant HUD's attention to provide greater assurance that the project is managed in the most economical and efficient manner. Specifically, contrary to regulations, (1) tenant accounts receivable and vendor accounts payable were not properly reported, (2) prudent procurement practices were not always followed, (3) advances were made by and partially repaid to the agent without HUD approval, and (4) action to mitigate cash-flow problems was not addressed in a timely manner, but has since been taken. As a result, the financial condition of the project was not accurately reported, assurance was lacking that procurements were executed at the most economical price, and late fees and high vacancy rates were incurred. This condition occurred because of weaknesses in controls over financial reporting, procurements, and cash management.

Accounts Receivable and Payable Not Properly Reported

Project tenant accounts receivable and vendor accounts payable were not properly reported. Section 6(b)(2) of the project owner's/management agent's certification requires that project accounts be maintained in accordance with HUD administrative requirements and generally accepted accounting principles.

Project financial statements for the period ending June 30, 2008, reported tenant accounts receivable of $82,540 as a current asset. However, the agent acknowledged that $79,652, or 97 percent of the reported receivable, represented noncurrent and known uncollectible tenant receivables, some of which dated back to the inception of the project in 1988. This condition occurred because the agent had not established procedures to write off uncollectible tenant accounts receivable. In addition, vendor accounts payable were not recorded in a timely manner. Accounts payable of $20,765 were recorded from two to seven years after the invoice date. The agent stated that the vendor submitted invoices late, and, therefore, accounts payable were recorded and paid late. This condition occurred because the agent had not established controls to ensure that completed work orders were tracked to invoices to establish accounts payable. Further, an accounts payable accrual was made for $1,700 more than the authorized contract amount. As a result, HUD was unaware of the project's financial position because current assets and liabilities were not accurately reported.

Prudent Procurement Practices Not Followed

The agent procured professional services and awarded contracts without soliciting bids or obtaining oral or written cost estimates as required by HUD and/or its own regulations. HUD Handbook 4381.5, The Management Agent Handbook, paragraph 6.50(a), provides that a management agent should solicit written cost estimates from at least three contractors or suppliers for any contract for ongoing supplies or services expected to exceed $10,000 per year. Paragraph 6.50(b) provides that for any contract for ongoing supplies or services estimated to cost less than $5,000 per year, the agent should solicit verbal or written cost estimates to ensure that the project is obtaining services, supplies, and purchases at the lowest possible cost. The agent executed audit service contracts for $11,650 and $13,350 in 2007 and 2008, respectively, without soliciting bids. In addition, the agent executed legal and elevator service contracts for annual amounts of $4,200 and $6,000, respectively, without obtaining cost estimates as required.

Paragraph 4 of the project owner's/management agent's certification requires that the agent document the reasons for accepting other than the lowest bid, and the agent's procedures require that the reasons for selection of other than the lowest bidder be documented via internal memorandum and attached to the disbursement documentation. However, a $31,470 contract for roof repairs was awarded to other than the lowest bidder without documenting the reasons for the selection. These conditions occurred because the agent failed to comply with the project owner's/management agent's certification and its procurement procedures. As a result, assurance was lacking that the most economical price was obtained for these services.

Receipt and Repayment of Advances without HUD Approval

Section 7(a) of the regulatory agreement prohibits an owner from encumbering personal property of the project without written approval from HUD. The management agent made two interest-free advances of $117,448 and $17,000 on May 5, 2003, and July 8, 2004, to the project for the payment of past-due real estate taxes and water and sewer charges, respectively. These advances were made without HUD approval. In addition, $72,000 of the advance amount was repaid to the agent from project funds without HUD approval while the project was in a non-surplus-cash position. During the period in which this was repaid, the project also had not made payments in a timely manner to the reserve for replacement account and had not yet fully repaid a $50,000 advance from the reserve for replacement account approved by HUD (which was paid in full in

May 2008). This condition occurred because of the agent's unfamiliarity with HUD regulations and resulted in less cash being available for project use.

Cash-Flow Problems Not Addressed in a Timely Manner

The project experienced significant cash-flow problems. As a result, late fees were incurred, and as noted previously, advances were obtained from the management agent to continue operations. However, action to mitigate cash-flow problems was not always taken in a timely manner. Specifically, the agent did not address its reported excessive vacancy rate in a timely manner or ensure that its housing assistance payments contract was renewed on time. HUD Handbook 4381.5, REV-2, CHG-3, The Management Agent Handbook, chapter 2, section 2.5, provides that the owner and HUD must be assured that the project will be managed in a prudent, efficient, and cost-effective manner in accordance with applicable laws and HUD rules, contracts, and procedures.

Paragraph 4(a) of the project owner's/management agent's certification requires the agent to ensure that all expenses of the project are reasonable in amount and necessary to the operation of the project. Nevertheless, the project incurred late payments and interest charges on utility and tax bills. Finance charges of $13,043 were paid in March 2009 for late payments to an oil company, $37,222 in interest was factored into an installment agreement entered into in December 2008 for late payments of real estate taxes, and $266 in late payment charges was paid to a utility company. In addition, a $305 deposit imposed due to late utility payments was misclassified as interest and penalties. These charges could have been avoided if adequate controls had been established to address the cash-flow problems that resulted in the excessive finance and interest charges in a timely manner.

For example, the project's fiscal years 2007 and 2008 financial statements reported vacancy losses of $81,961 (6 percent) and $139,937 (10 percent), respectively. In addition, the contract administrator's review of the project in both 2008 and 2009 noted that the vacancy and turnover rate for rentals was excessive. Agent officials stated that these losses resulted from a roof leak that prevented renting units on the upper floor and difficulty in renting its studio apartments. The officials also stated that the leak had existed from the project's inception and the first work order to repair it in 2006, for which $22,800 was spent, was not adequate and was unsuccessful. Thus, an additional $31,470 was spent in 2008 to correct the leak. While the agent stated that it took two years to order the second repair in 2008 because funds were not available, project bank statements reported that $91,000 and $147,000 were available in the reserve for replacement account in January and December 2007, respectively. Therefore, funds were available that could have been used to address the needed repairs and, possibly, the cash-flow problems.

Further, although HUD's Section 8 Renewal Policy, chapter 2, paragraph 2-2C, requires that owners submit required documentation for a Section 8 housing assistance contract renewal at least 120 days before expiration of the contract, the project experienced delays in submitting the renewal for its housing assistance contract that expired on February 22, 2009. Consequently, the project did not receive four months of housing assistance payments of $394,637 in a timely manner. This condition worsened the project's cash-flow problems and required the agent to request HUD approval for advances from the reserve for replacement account in April and June 2009 for $51,345 and $68,217, respectively. The project was fully leased and had repaid the most recent HUD-approved advance from the reserve for replacement account when housing assistance payments were received in May and July 2009. However, if adequate controls had been in place, the agent could have avoided these cash-flow problems and unnecessary late fees and finance charges.

Conclusion

While the agent generally complied with HUD regulations in its management of the project, various issues warrant HUD's attention to provide greater assurance that the project is managed in the most economical and efficient manner and to ensure that the project's financial condition is accurately reported. In addition, while the project had addressed issues that contributed to its continually needing to apply for advances and to incur late fees and finance charges, attention needs to be given to ensuring that the project will remain financially viable going forward.

Recommendations

We recommend that the Director of the New York Office of Multifamily Housing instruct the agent to

1A. Determine the collectability of the $79,652 delinquent tenant accounts receivable and write off any amounts determined to be uncollectible.

1B. Establish procedures to write off uncollectible receivables to ensure accurate reporting of the project's financial position.

1C. Strengthen controls to ensure that accounts payable are recorded in a timely manner to ensure that the project's financial position is accurately reported.

1D. Obtain board approval or otherwise deobligate the $1,700 accrued expense payable in excess of the authorized contract amount.

1E. Strengthen controls over obligation of funds to ensure that obligations do not exceed authorized amounts.

1F. Strengthen procedures to ensure compliance with HUD Handbook 4381.5, paragraph 6.50(a), regarding soliciting cost estimates, and the agent's own procedures that require soliciting bids, obtaining and retaining written cost estimates, and documenting the reasons for the selection of other than the lowest bidder.

1G. Implement controls to ensure that management agent advances are repaid only when in a surplus cash position, and if not, only after approval by HUD.

1H. Reclassify the $305 reported as interest and penalties as a deposit.

1I. Strengthen controls to ensure that all bills are paid in a timely manner to avoid unnecessary late payment charges, finance charges, and interest charges.

1J. Strengthen procedures to ensure that housing assistance payments contracts are renewed and vacancies are addressed in a timely manner.

1K. Provide an analysis of ongoing and projected future income and expenses to document that the project will continue to be financially viable.

SCOPE AND METHODOLOGY

Our review generally covered the period July 1, 2006, to June 30, 2008, and was performed between May and July 2009 at the agent's office located in the Bronx, New York.

To accomplish the objectives, we

- Reviewed the project regulatory agreement, project owner's/management agent certification, and applicable HUD handbooks and regulations to document the responsibilities of the project owner and management agent.

- Documented the project's policies and procedures to ensure that they complied with HUD requirements.

- Analyzed the project's audited financial statements and financial records, including general ledgers, bank statements, check registers, expenditure vouchers, and supporting documentation for the audit period.

- Reviewed the three most recent contract administrator reviews and Real Estate Assessment Center (REAC) inspection reports. We did not conduct housing quality standards inspections because a score of 80 was received from the most recent (July 2009) REAC inspection.

- Interviewed HUD multifamily hub and management agent officials.

- Confirmed selected invoices with a third-party vendor.

- Reviewed the project's fidelity bond policy.

- Reviewed tenant rent collection procedures.

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

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

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

Relevant Internal Controls

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

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

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.

Significant Weaknesses

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

The agent lacked adequate controls to ensure that the project was managed in the most economical and efficient manner in compliance with HUD regulations (see finding).

Appendix A

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

Recommendation number	Funds to be put to better use 1/
1D	1,700
1H	305
	$2,005
	======

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the improper accrued expense is corrected, an additional $1,700 will be deobligated and made available to the project, and if the $305 deposit is reclassified, it will be appropriately reported as a restricted asset.

Appendix B

AUDITEE COMMENTS

South Bronx Community Management Co., Inc.

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October 20, 2009

Mr. Edgar Moore
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General
26 Federal Plaza, Room 3430
New York, New York 10278 0068

Dear Mr. Moore:

This is a response to the various issues warrant as per your audit to the Project of Maria Isabel Housing Development Fund Corp. discussed at the exit conference on October 20, 2009.

Attach are the comments on the various issues warrant.

If any further questions, comments or concerns, please do not hesitate to call me at 718-585-4818- ext. 313, 718- 993-3504 ext. 313 or can e-mail me at cusalu2002@yahoo.com

Sincerely,

Madelyn Lugo
Controller
South Bronx Community Management Co. Inc.

Cc: Mr. Carlos Velasquez, Chairperson, Board of Director's –Maria Isabel HDFC
Mr. Ramon Velez, Jr. President-SBCMC, Inc.
Files

EQUAL HOUSING OPPORTUNITY

AUDITEE COMMENTS

Accounts Receivable and Payable not properly reported

The tenant's accounts receivable skip was write off in this past fiscal year ending June 30, 2009 in the amount of $37.542.00. During this current fiscal year ending in June 30, 2010 the owner's project/management agent's will be writing off the rest of the account receivable that is maintained as an asset in the financial statement, most of the tenants are non-existing tenants for ended are uncollectible. In the future no accounts receivable that are mark as uncollectible will be maintained as an asset to avoid the situation to show non-existing assets in the situation of the financial statement. Proper procedures are been established in order to ensure accurate reporting of the project's financial position.

Accounts payable are been recorded in the timely manner and work order has been tracked in order to avoid delay in record any accounts payable. Control has been established in order to avoid late charges, penalties or late payment to ensure that the project's financial position is accurately reported.

The payable accrual of $1,700.00 more than authorized contract amount was deobligated. A credit memo was issued. Controls have been established to assure that obligations do not exceed the authorized amounts by owners project.

Prudent Procurement Practices not followed

The project owner's/management agent has strengthen the procurement procedures for soliciting cost estimates, written or verbal. Documentation track has been evaluated and procedures have been review and established in order to secure the selection of the proper supplier or vendor to ensure that the most economical price are obtained for whatever services are needs. If the award go to a supplier or vendor other than the lower price, procedures has been established to assure the reason for the selection and follow up with the compliance with the project owner's /management certification and the procurement procedures, always assurance that first the most economical price will be taking into consideration.

Receipt and Repayment of Advances without HUD Approval

Management Company made the loans free of interest to the project without HUD Approval to cover Real Estate Taxes and Water and Sewer charges that were in arrears. The management agent will not encumbering any personal property without written approval from HUD. No repayment will be made if HUD does not approved and Cash flow position of the project permitted. Current charges have been paid and also in rem-agreement are up to date in payments in order to avoid the mentioned situation. Financial steps in taking care to avoid future situations.

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AUDITEE COMMENTS

Cash –Flow Problems Not Addressed in a Timely Manner

Due to a cash flow problem project experimented a significant problems, Project owner's /management agent are taking significant steps in order to correct the cash flow problems avoiding to pay interest, finance charges or late payment due to the financial situation the project was confronting due to the excessive vacant units. Vacancies in the project are been rented, project start receiving the full rental income to cover and maintain the operations and the housing standards. A waiting list are maintained up dated, as soon as a unit become vacant, a next persons in the list are been call and schedule to go on process for qualification and possible candidates to occupy unit. Units are been prepared for rented within the 15 days of vacant in order to be occupied by the 30 days.

The rental of the units will be maintaining the project out the significant cash flow problems. A forecast of income and expenses is maintained in order to assure that bills are paid on a timely basis avoiding to pay any interest, penalties or security deposits. Procedures have been revised and strengthen in order to assure a good financial position to the project.

The $305 reported as interest and penalties was reclassify as a security deposit for the utilities account. A journal entry was made in order to reclassify to the right account in our general ledger and to show as an asset in the financial statement.

The renewal HAP contract package for the next year that become effective in February 22, 2010 was already submitted to the Administrator contract for the Project (CGI) last month of September, 2009. This avoids the delay process in the contract that was happened in this current year. Project owner's/management agent's are secure the financial position of the project and comply with the 120 days requirements accordingly to the Regulatory agreement. Unnecessary late fees, finance charges or security deposits are avoiding. Procedures have been revised and necessary steps have been taken in consideration for futures contracts.

A forecast analysis of the project is provided. On the analysis of ongoing and projected future income and expenses the project show that will be continue financially viable.

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