



Issue Date November 25, 2009
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Audit Report Number 2010-PH-1003
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TO: Charlie Famuliner, Director, Multifamily Program Center, Richmond Field Office, 3FHML

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FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

SUBJECT: The Yorkville Cooperative, Fairfax, Virginia, Did Not Administer Its Section 221(d)(3) Property and Housing Assistance Contract According to Its Regulatory Agreement and HUD Requirements

## **HIGHLIGHTS**

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

We audited the Yorkville Cooperative (Cooperative) based on a request from the U.S. Department of Housing and Urban Development's (HUD) Richmond Multifamily Program Center and a citizen complaint. The objective of the audit was to determine whether the Cooperative administered its Section 221(d)(3) property and housing assistance contract according to its regulatory agreement and HUD requirements.

### **What We Found**

The Cooperative did not administer its Section 221(d)(3) property and housing assistance contract in accordance with its regulatory agreement and HUD requirements. Specifically, it used operating funds to pay for ineligible expenses (legal fees and resident promotions) and made erroneous calculations and unsupported housing assistance payments on behalf of its board members. It also

billed HUD for housing assistance payments it may not have been eligible to receive.

### **What We Recommend**

We recommend that the Director of the Richmond Multifamily Program Center require the Cooperative to reimburse its operating account from nonfederal funds \$243,772 for ineligible expenses. Also, the Cooperative needs to develop and implement adequate procedures and controls to ensure that disbursements made from its operating account are for expenses that are reasonable, necessary, and in accordance with program requirements. We further recommend that the Cooperative reimburse HUD from nonfederal funds \$14,313 for the overpayment of housing assistance payments and provide support or reimburse HUD \$66,850 from nonfederal funds for unsupported housing assistance payments. The Cooperative also needs to develop and implement procedures to ensure that housing assistance payments are correctly calculated and supported with the required documentation.

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 findings with Cooperative officials during the audit. We provided a copy of the draft report to the Cooperative on October 22, 2009, for its comments and discussed the report with the officials at the exit conference on November 6, 2009. The Cooperative provided its written comments to our draft report on November 13, 2009. In its response, the Cooperative generally disagreed with the results.

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

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The Yorkville Cooperative (Cooperative) was organized on July 15, 1977, for the purposes of acquiring, rehabilitating, and operating as a cooperative housing project under Section 221(d)(3). The affairs of the Cooperative are governed by a board of directors which consists of five members. The Cooperative is located at 3146 Draper Drive, Fairfax, Virginia.

The U.S. Department of Housing and Urban Development (HUD) entered into a regulatory agreement with the Cooperative in 1979 for HUD's Section 221(d)(3) insured multifamily program. The Section 221(d)(3) program insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly, and the handicapped. Section 221(d)(3) mortgages are for nonprofit sponsors or cooperatives up to 100 percent of the HUD/Federal Housing Administration estimated replacement cost of the project.

The regulatory agreement also provided the Cooperative the use of housing assistance payments contracts for its units. The Cooperative executed a Section 8 contract with HUD for 237 units. Currently, 229 units are occupied, and eight are vacant. Based on HUD's Tenant Rental Assistance Certification System assistance payment report, the Cooperative received \$2.2 million in calendar year 2008.

During our audit period, HUD authorized the Cooperative the following financial assistance for the housing assistance payments:

<b>Fiscal year</b>	<b>Authorized funds</b>	<b>Disbursed funds</b>
2006	\$1,405,123	\$1,405,123
2007	\$2,427,715	\$2,427,715
2008	\$2,823,100	\$2,786,670
2009	\$2,956,624	\$854,372
2009	\$394,775	\$394,775 <sup>1</sup>
<b>Totals</b>	<b>\$10,007,337</b>	<b>\$7,868,655<sup>2</sup></b>

The objective of the audit was to determine whether the Cooperative administered its Section 221(d)(3) property and housing assistance contract according to its regulatory agreement and HUD requirements.

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<sup>1</sup> The Cooperative received \$394,775 in additional supplemental funding due to the American Recovery and Reinvestment Act of 2009.

<sup>2</sup> According to financial information obtained from the Richmond Multifamily Program Center, the Cooperative has \$2.1 million available to use for its program.

## RESULTS OF AUDIT

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### Finding 1: The Cooperative Used Funds from Its Operating Account to Pay for Ineligible Expenses

The Cooperative paid \$225,640 in ineligible expenses to include legal fees associated with refinancing its property, former management agent fees, and board of directors' meeting expenses. Additionally, it improperly used operating funds totaling \$18,132 to pay for social gatherings, promotions, a flat screen television and a video game console. This problem occurred because the Cooperative disregarded HUD requirements. Also, it had not developed and implemented adequate procedures and controls to ensure that disbursements made from its operating account were for eligible expenses in accordance with program requirements. As a result, \$243,772 was unavailable to pay for the Cooperative's necessary operating expenses and repairs.

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#### The Cooperative Paid Expenses That Were Not Eligible

The Cooperative paid \$243,772 for expenses that were ineligible. Specifically, it paid \$225,640 in legal fees and \$18,132 for other expenses that were not operating expenses of the project. The table below shows the expenses that were ineligible.

Attorney legal fees	\$225,640
Social gatherings & promotions	\$15,632
Flat screen television and video game console	\$2,500

We reviewed legal fees, totaling \$257,420, paid to the Cooperative's attorney from January 2006 to December 2008. Of the \$ 257,420 reviewed, the Cooperative improperly paid its attorney \$225,640 from operating funds for services associated with the refinancing of the property, its former management agent, and the attorney's attendance at recurring board of directors meetings. However, the services provided by the attorney were entity related and were not operating expenses of the project. When the Cooperative became aware that the legal expenses were not operating expenses, it reclassified the expenses as entity expenses. However, it continued to use operating funds to pay for these reclassified expenses. According to HUD Handbook 4370.2, the legal expense account should only be used for fees associated with rental collections. Additionally, appendix 3b of HUD Handbook 4381.5 states that the management agent will comply with HUD handbooks, notices, or other policy directives that relate to management of the project and ensure that all expenses of the project are reasonable and necessary. The legal fees paid were neither reasonable nor necessary operating expenses. Further,

the legal expenses paid were not for the operating costs of the project but were entity expenses. Thus, legal expenses paid, totaling \$225,640, were ineligible.

The Cooperative also used \$18,132 in operating funds to pay for annual and monthly board meetings, food, social parties, a flat screen television, and a video game console. During the audit, we asked responsible officials to show us the flat screen television and the video game console, and neither item could be located. Paragraph 8(b) of the Cooperative's regulatory agreement states that owners shall not without the prior approval of the HUD Secretary assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except for reasonable operating expenses and necessary repairs. Thus, the disbursements paid were ineligible.

### **The Cooperative Disregarded HUD Requirements**

The Cooperative disregarded HUD requirements. It believed that as a low-income project, it had no alternative but to use operating funds to pay for its legal expenses and to provide social activities for its members. As noted above, paragraph 8(b) of the regulatory agreement does not allow the use of operating funds to pay for social gatherings. HUD Handbook 4370.2 requires that the legal expense account only be used for fees associated with rental collections. There were no documents available indicating that HUD approved any budgets authorizing the use of operating funds to pay for annual and monthly board meetings, food, various parties, a flat screen television and legal fees not associated with rental collections.

### **Conclusion**

The Cooperative's actions resulted in more than \$243,000 being unavailable to pay for necessary operating expenses and repairs. The Cooperative needs to follow HUD requirements regarding the use of its operating accounts. It had not developed and implemented adequate procedures and controls to ensure that disbursements made from its operating account were for expenses that were reasonable, necessary, and in accordance with program requirements. Once the Cooperative develops and implements these controls, an estimated \$81,257 will be used for eligible purposes annually.

## Recommendations

We recommend that the Director of the Richmond Multifamily Program Center require the Cooperative to

- 1A. Reimburse its operating account from nonfederal funds \$243,772 for ineligible expenses.
- 1B. Develop and implement adequate procedures and controls to ensure that disbursements made from its operating account are for expenses that are reasonable, necessary, and in accordance with program requirements, thereby ensuring that an estimated \$81,257 will be used for eligible purposes annually.

## Finding 2: The Cooperative Did Not Adequately Administer Housing Assistance Payments in Accordance with HUD Requirements

The Cooperative did not always administer housing assistance payments in accordance with HUD requirements. Specifically, it did not maintain adequate documentation to support \$54,180 in housing assistance payments during periods it made rental concessions. It also overpaid \$14,313 and could not adequately support another \$12,670 in housing assistance payments it made for units occupied by members of its board of directors. These problems occurred because the Cooperative disregarded HUD requirements and its management agent did not perform adequate supervisory oversight of its former occupancy specialist. Overall, it was unable to adequately support \$66,850 in housing assistance payments, and it improperly overpaid \$14,313 in housing assistance.

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**The Cooperative Billed HUD \$54,180 in Housing Assistance Payments Which It May Not Have Been Entitled to Receive**

The Cooperative granted 112 rental concessions<sup>3</sup> totaling \$80,686 and in the same month, billed HUD for housing assistance payments totaling \$54,180 for the same tenants, which is prohibited. We reviewed a schedule of rent concessions that the Cooperative granted between March 2006 and December 2008. According to the schedule reviewed, the rent concessions ranged from \$64 to \$9,877 and totaled \$80,686. We compared the names of the tenants that were granted rent concessions to the Cooperative's housing assistance register to determine whether housing assistance payments were made for the same tenants. During the month in which the rent concessions were made, the Cooperative billed HUD \$54,180 in housing assistance payments for the same tenants.

According to HUD Handbook 4350.3, REV-1, chapter 9, paragraph 12-5, if the owner grants a rent concession, the owner cannot bill HUD for either the rental assistance or the tenant's portion of the rent for the month or months in which the concession is given.

The Cooperative stated that the \$80,686 was not rent concessions but was for adjustments and write-offs for uncollectable rents. Without adequate documentation to support that the amounts were adjustments and write-offs and not rental concessions, the housing assistance payments billed to HUD are classified as unsupported. Thus, the Cooperative needs to provide adequate support for those adjustments.

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<sup>3</sup> Rental concessions is a period in which a tenant receives free rent.



### **The Cooperative Incorrectly Calculated Housing Assistance Payments**

The Cooperative incorrectly calculated housing assistance payments, resulting in overpayments of \$14,313 for the period 2005 through 2009 for units occupied by five members of its board of directors. To determine whether the Cooperative correctly calculated housing assistance payments, we reviewed 30 annual reexaminations for the five tenant files. The Cooperative incorrectly calculated housing assistance payments in all five files reviewed. The Cooperative did however properly determine eligibility for the members of its board of directors.

### **The Cooperative Lacked Proper Documentation to Support Housing Assistance Payments**

The Cooperative lacked proper documentation to support housing assistance payments totaling \$12,670 made for units occupied by five members of the board of directors during the period 2005 through 2009. Our review of housing assistance, totaling \$154,738, resulted in unsupported housing assistance payments totaling \$12,670. Of the five board members' tenant files reviewed, two files did not contain documentation to support items such as income, medical allowance, and full-time student status.

Although the deficiencies noted above were in essence documentation issues, the lack of documentation was material and resulted in the Cooperative's making unsupported housing assistance payments of \$12,670.

### **The Cooperative Disregarded HUD Requirements and Did Not Perform Adequate Supervisory Oversight of its Former Occupancy Specialist**

The Cooperative disregarded HUD requirements regarding subsidy contract responsibilities. HUD Handbook 4350.3 and other HUD regulations required the Cooperative and its management agent to ensure that the computation of tenant rents, assistance payments, recertifications, and other subsidy contract responsibilities were performed in accordance with HUD requirements.

Neither the Cooperative nor its management agent performed adequate supervisory oversight of its former occupancy specialist. The Cooperative's lack of supervision of its former occupancy specialist contributed to the deficiencies

noted above. The former occupancy specialist was dismissed before we started this audit. None of the recertifications reviewed was signed or reviewed by the supervisor or its management agent. The management agent stated that although a review of the files was not performed by its office, the Cooperative's staff conducted a full review of tenant files. However, as of the date of this report, the Cooperative had not provided evidence showing that a review had been performed.

## Conclusion

The Cooperative did not always maintain adequate support documentation for housing assistance payments made, incorrectly calculated housing assistance payments, and billed HUD for housing assistance payments it may not have been eligible to receive. As a result, it disbursed \$66,850 without proper documentation and incorrectly calculated housing assistance payments, resulting in \$14,313 in overpayments. The Cooperative needs to develop and implement procedures to ensure that housing assistance payments are correctly calculated and supported with the required documentation.

## Recommendations

We recommend that the Director of the Richmond Multifamily Program Center require the Cooperative to

- 2A. Provide documentation to support \$54,180 it billed HUD during the period it granted rental concessions or reimburse its program from nonfederal funds.
- 2B. Discontinue the practice of billing HUD for housing assistance payments in the same month in which rental concessions are granted.
- 2C. Correct the errors in the tenant files identified by the audit.
- 2D. Reimburse its program \$14,313, from nonfederal funds for the overpayment of housing assistance for units occupied by five members of its board of directors.
- 2E. Provide documentation to support housing assistance payments totaling \$12,670 for units occupied by two members of its board of directors or reimburse its program from nonfederal funds.
- 2F. Develop and implement procedures to ensure that housing assistance payments are correctly calculated and supported with the required documentation. The procedures, at a minimum, should include a

statement from management certifying that the determined housing assistance payment amounts have been reviewed by management and prepared in accordance with HUD requirements.

## SCOPE AND METHODOLOGY

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To accomplish our objective, we reviewed

- The regulatory agreement between HUD and the Cooperative; HUD Handbooks 4350.3 (Occupancy Requirements for Multifamily Programs), 4370.2, REV-1 (Financial Operations and Accounting Procedures for Insured Multifamily Projects), 4350.1 (Multifamily Asset Management Project Servicing), and 4381.5 (Management Agent Handbook, appendix 3b: HUD-9839-B, Project Owner's and Management Agent's Certification for Multifamily Housing Projects for Identity-of-Interest or Independent Management Agents).
- The Cooperative's accounting records, audited financial statements for 2007 and 2008, tenant files, computerized databases including housing assistance payment register and the general ledger, board meeting minutes from January 2006 to March 2009, organizational chart, and housing assistance contract.
- HUD's monitoring reports for the Cooperative.
- Twenty eight invoices associated with legal fees from January 2006 to December 2008 and 20 disbursements from the general ledger associated with social gatherings from January 2006 to March 2009.
- Thirty annual reexaminations for five tenant files, totaling \$154,738, made between 2005 and 2009 to the five members of the Cooperative's board of directors to determine eligibility and whether their housing assistance payments were accurately calculated.
- The schedule of 112 rental concessions granted during our audit period.

We also interviewed the Cooperative's employees and HUD staff.

For the period of January 2006 through December 2008, the Cooperative paid ineligible expenses totaling \$243,772 related to legal fees and social gatherings and promotions. We estimated that the Cooperative will put \$81,257 ( $\$243,772$  divided by three years =  $\$81,257$ ) to better use annually by developing and implementing adequate procedures and controls to ensure that disbursements made from its operating account are for expenses that are reasonable, necessary and in accordance with program requirements.

To achieve our audit objective, we relied in part on computer-processed data in the Cooperative's databases. 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 performed our on-site audit work from April through June 2009 at the Cooperative's office located at 3146 Draper Drive, Fairfax, Virginia. The audit covered the period January 2006 through March 2009 but was expanded when necessary to include other periods.

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 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.

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

We assessed the relevant controls identified above.

A 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 items are significant weaknesses:

- The Cooperative did not establish and implement adequate controls to ensure that operating funds were only disbursed for reasonable and eligible expenses.
- The Cooperative did not establish and implement adequate controls to ensure that housing assistance payments were accurate and properly supported.

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	\$243,772		
1B			\$81,257
2A		\$54,180	
2D	\$14,313		
2E		\$12,670	
<b>Totals</b>	<b>\$258,085</b>	<b>\$66,850</b>	<b>\$81,257</b>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General 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 Cooperative implements our recommendation, it will cease to incur program costs that are ineligible, unnecessary, or unreasonable. We only estimated the initial year of this benefit. Once the Cooperative successfully improves its controls, this will be a recurring benefit.



## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments



**YORKVILLE**  
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November 12, 2009

Mr. John P. Buck  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
The Wannamaker Building  
100 Penn Square  
Philadelphia, PA 19107-3380

Dear Mr. Buck:

Re: Yorkville Cooperative  
HUD Project – VA39-H027-025

This letter is our response to the draft Audit Report sent on October 22, 2009 for the Yorkville Cooperative located at 3146 Draper Drive, Fairfax, Virginia 22031. We understand that this letter will be published along with the final report; we trust you will take into consideration the contents of this response and amend the final Audit Report accordingly. As previously discussed with you, we disagree with the findings of the Audit Report and believe that the Yorkville Cooperative did administer its Section 221 (d) (3) property and Section 8 Housing assistance contract in accordance with the Regulatory Agreement and HUD requirements. We also do not believe that the report accurately reflects the management operations of the Cooperative or the seriousness with which the Board of Directors exercises its responsibilities and duties.

In order to understand our position on your Findings and Recommendations, it is important to provide some context. It is our belief that your office did not provide sufficient weight to our unique circumstances.

Yorkville Cooperative is a residential cooperative housing community, designed to serve low income families and individuals. Under the statutory restrictions of the programs in which we operate, the financial circumstances of the cooperative are under the control of the Department of Housing and Urban Development. HUD sets the maximum charges which may be collected. There is no way that Yorkville Cooperative can increase its revenues (either by increasing monthly charges or admitting wealthier residents) without HUD approval. And, for the most part, HUD approvals would not be forthcoming both because of legal restrictions and because serving higher income sectors

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### **Comment 1**

of the populations would compromise the mission of both Yorkville Cooperative and HUD.

But, with all of this, the cooperative is a business, and must run as a business. For this reason, we have a Board of Directors, all volunteers and all residents, who devote countless hours to all aspects of this community. We have a highly respected professional management company, experienced and conversant with HUD's many requirements. But this is sometimes not sufficient. Most importantly, as a legal body with legal requirements to meet, we have needed to engage attorneys and advisors to assist us with their expertise. Yorkville Corporation is a Virginia Nonstock Corporation. Virginia law requires the Board of Directors to perform its duties in accordance with its good faith business judgment in the best interests of the Corporation. The law provides that a Director is entitled to rely on information and opinions of legal counsel, public accountants, or other persons for the benefit of the overall community.

This does not make us any different from a privately owned residential community. We need to provide good housing, support a safe and viable community, and meet all legal requirements as they arise. But we differ from a privately owned residential community in that we have no external resources to call on. We can only use the project revenue that we generate through our normal operations.

We understand that low income cooperatives are not necessarily favored by the Department of Housing and Urban Development of today. Nevertheless, Yorkville Cooperative is a low income cooperative, and a very successful one at that.

**Comment 1**

The crux of the findings of the draft Audit Report is that the cooperative used project funds to pay for expenses that were not eligible operating expenses. It is our position that, when determining whether the cooperative's expenses were eligible operating expenses or not, the OIG is making a mistake if it uses the same definition that it might use if auditing a for-profit owner. For, as we stated above, while the for-profit owner has other sources of revenue to meet such expenses, a low income cooperative does not.

**Comment 2**

We discussed this question at some length at the exit conference held on Friday November 6, 2009. You expressed an understanding and appreciation of our point of view, but stated that the HUD regulations and handbook did not provide for any distinction between the treatments of these very different ownership structures, and it was the job of your office to look at compliance with those regulatory and handbooks requirements as they in fact exist. You said that HUD's policy may (or may not) be correct, but that the policy is as it is stated.

**Comment 3**

We do not agree that the definition of 'reasonable operating expenses' has to be the same for each type of property, and therefore disagree with your findings based upon the restrictive definition of the term. You suggested that, perhaps, during the audit resolution process with the Richmond field office, that the field office could request waivers of various handbook provisions and that if those requests were looked upon

favorably by HUD Headquarters, that such approvals could lead to closing some of the findings. While we do not object to that in a broad sense, it seems to us that it simply increases the time, anxiety and (most importantly) expense that would be involved in seeing this process through to the end, when one of the ultimate goals is to save on such types of expenses.

With this in mind, the following is our response to each finding:

**Finding 1: The Cooperative Used Funds from Its Operating Account to Pay for Ineligible Expenses.**

**Response:**

The Cooperative did engage the services of an attorney to provide guidance for a refinance and future rehabilitation of the Cooperative. These are very technical matters, as you know, and cannot be approached without experienced professional help. The need for refinancing has become apparent as our property is aging. The HUD field office had suggested that the cooperative sell the property to a for-profit development company, something that the Board of Directors and the membership did not want to do, and saw no need to do. After the sale was suggested, the need to look for alternative ways to guarantee the future of the property was required to be expedited.

It is true that the Board of Directors was informed that they could not use of operational funds to pay for legal fees in a letter from the Richmond Field Office on January 12, 2009. But, the Board of Directors was surprised by this letter because the Board had met with the Richmond field office to discuss the issue of a refinance and redevelopment with them. Also present at that meeting was the attorney for the Cooperative. There were no issues regarding the engagement of an attorney, neither at that time nor in any other communications between the attorney and Mr. Charles Famuliner, Director of Multifamily Housing in the Richmond field office. We can only assume that the Richmond field office was aware that lawyers engaged in this sort of work would require payment for their services, and that the Cooperative's only source of funding was its operational income. Equally important, the Board of Directors sent three letters to the Richmond field office requesting a meeting to discuss this issue. The Richmond field office, for reasons which have never been explained to us, made no response to these letters.

The Board of Directors believes strongly that it was their responsibility and duty to acquire these services because they are services that benefit every member of the Cooperative and the property itself and thus are not entity expenses but operational expenses.

## Comment 5

While the legal fees constitute the largest expense cited in the audit, there are others as well. The Board of Directors was equally surprised that the Inspector General concluded that the use of Operational Funds to cover expenses for the Cooperative's Annual Meeting and Monthly Meetings are not eligible expenses. These are not social events but are business meetings and are a requirement of the By-Laws of the Cooperative, which were approved by HUD. HUD was aware of these meetings and in the past has attended these business meetings. Budget Worksheets have been submitted with these costs included in the Budget Worksheet, form HUD-92547-A as required each year. At no time was the Cooperative made aware that these were not eligible funds; we assume that the field office believed, and perhaps still believes, that they are eligible expenses.

The purchase of a flat screen television and video game console were purchases made to further enhance the social and educational training of the children and adult members of the Cooperative. The Board of Directors believes that these too are operational expenses because they benefit every member of the Cooperative and not entity expenses of the Corporation. Clearly, furnishing the property's office and community room constitute eligible expenses. We wonder why these two items are not. The only difference is that they are electronic devices, and there is nothing we know that would exclude payment for something on that basis.

The Board of Directors concludes that these expenses are reasonable, necessary, and in accordance with HUD program guidelines.

**Finding 2: The Cooperative Did NOT Adequately Administer Housing Assistance Payments in Accordance with HUD Requirements.**

### **Response:**

## Comment 6

We understand that HUD has a policy that says that if concessions are granted to residents, (thus lowering their otherwise due monthly payment), Section 8 subsidies cannot be requested for the same period of time. The problem is that this never occurred and, for some reason, the Office of Inspector General cannot understand this.

The Board of Directors disagrees that concessions were given to residents during the period between March 2006 and December 2008. The OIG is confusing adjustments made to correct either calculation errors made for a certification or interim certifications with rent concessions. Chapter 19 of the 4350.3 clearly provides guidelines to make adjustments due to a calculation error. We cannot understand why the auditors take a different position here.

The computer generated reports provided to HUD OIG clearly demonstrate and explain the reasons for every adjustment. Examples of these adjustments from the report include: Corrections to resident balances, system billing errors, late certifications, lack of proper 30 day notification of rental increase, failure of residents to re-certify, and

adjustments for late fees, and others. During the audit process, these issues were clearly explained. Unfortunately, the title of the generated software program used by our management agent is referred to is called a "Schedule of Concessions". Given that fact, we believe that is the only reason that the OIG staff has concluded that these adjustments were concessions. Unfortunately, the title of the computer report cannot be altered on the software program; but his does not transform the instances noted on the report to something that they are not.

**Comment 7**

The draft Audit Report states that there was not documentation to support housing assistance over payments of \$12,670. The Board disagrees in the finding. With the exception of two residents, these issues were corrected prior to the Audit Survey. In one of these cases, HUD-OIG was calculating income based on a 2009 income verification. That income would not have been used to calculate an income re-certification in 2008. We would not have had that information at that time. In the other situation, a correction was made for a medical allowance.

**Comment 8**

The draft Audit Report cited that neither the Cooperative nor its management agent performed adequate supervisory oversight of its former occupancy specialist. That occupancy specialist was dismissed. It should be noted that the occupancy specialist was dismissed as a result of necessary and adequate supervision. The dismissal of the occupancy specialist demonstrates that the report's conclusion is not correct.

**Comment 9**

The Cooperative's management staff conducted a full review of resident's files. The management agent's staff has also completed a full review of resident's files and regularly reviews files. The draft Audit Report also stated that "as of this date", of this report, the Cooperative had not provided evidence showing that a review had been performed". This is also incorrect. The management staff completed a full review prior to the Management Occupancy Review held in February 2009. Again we do not understand how the auditors can have possibly reached the conclusions that they did.

**Comment 10**

In conclusion, the Board of Directors strongly believes that we have established and implemented adequate controls to ensure that Operational Funds were disbursed for reasonable and eligible expenses. We also believe that we have established and implemented adequate controls to ensure that housing assistance payments were and continue to be accurate and properly supported.

We hope that this response will lead you to look anew at some of the conclusions that were reached during the audit process. We understand that, once the final audit is issued, we will be required to work out matters of resolution with the Richmond field office, although your office will be required to concur with them. The audit's findings, whether or not they are appropriate, are important; the method of resolution is more important. We at Yorkville are determined to resolve the audit in a constructive and professional manner. We hope that HUD will approach it with the same goals, so that we do not find ourselves at loggerheads over these issues to the detriment of the property and its residents.

Sincerely

  
Mr. Abdullah Mirre, President Yorkville Board of Directors

cc: Yorkville Board of Directors  
George Spreitzer, Vice President NDC Real Estate Management, Inc.

## OIG Evaluation of Auditee Comments

- Comment 1** The Section 221(d)(3) program insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly, and the handicapped. Section 221(d)(3) mortgages are for nonprofit sponsors or cooperatives up to 100 percent of the HUD/Federal Housing Administration estimated replacement cost of the project. As with all program participants, the Cooperative must follow applicable criteria in HUD Handbooks 4370.2, 4381.5, and the regulatory agreement while serving low-income families and individuals.
- Comment 2** The objective of this audit was to determine if the Cooperative was administering the program in accordance with its regulatory agreement and HUD criteria. The audit objective was not to evaluate whether the HUD criteria governing the Section 221 (d)(3) program was appropriate for nonprofit entities.
- Comment 3** Although the Cooperative disagrees with HUD's definition of a reasonable operating expense, the criteria of the program must be adhered to. HUD Handbook 4381.5 states that participants must comply with handbooks, notices or other policy directives that relate to the management of the project and ensure that all expenses of the project are reasonable and necessary. Audit results show that the Cooperative paid for expenses that were neither reasonable nor necessary operating expenses.
- Comment 4** The Cooperative should comply with the guidance it received from HUD's Richmond field office. According to HUD Handbook 4370.2, the legal expense account should only be used for fees associated with rental collections. Additionally, appendix 3b of HUD Handbook 4381.5 states that the management agent will comply with HUD handbooks, notices, or other policy directives that relate to management of the project and ensure that all expenses of the project are reasonable and necessary. The legal fees paid were neither reasonable nor necessary operating expenses.
- Comment 5** The Cooperative used operating funds to pay for food, social parties, a flat screen television, and a video game console. These are not reasonable or necessary operating expenses. Further, the Cooperative could not locate the flat screen television or the video game console when we asked to see them.
- Comment 6** The Cooperative has not provided adequate evidence to show that the amounts listed in its schedule of concessions report were in fact adjustments and not rent concessions.
- Comment 7** The Cooperative's statement that our office used incorrect income for two recertifications is not correct. To calculate income, we used the income information that was included in the tenant file. During the audit, we requested that the Cooperative provide documentation to nullify the exceptions found. The

Cooperative did not provide adequate documentation; thus the housing assistance payments were classified as unsupported.

**Comment 8** Neither the Cooperative nor its management agent performed adequate supervisory oversight of its former occupancy specialist. Of the five tenant files reviewed, none of the recertifications were signed or reviewed by the supervisor or its management agent.

**Comment 9** The Cooperative and its management agent failed to provide documentation showing when the review was performed, who performed the review, or the results of the review.

**Comment 10** The audit identified internal control weaknesses with the Cooperative's administration of its Section 221(d)(3) program that should be corrected.