



Issue Date	November 2, 2011
Audit Report Number	2012-DE-1001

TO: Marcie D. LaPorte, Director, Denver Multifamily Hub, 8AHML

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

SUBJECT: Five Star Services, Inc., Fargo, ND, Did Not Submit Monthly Accounting Reports and Section 236 Excess Income Reports to HUD

HIGHLIGHTS

What We Audited and Why

We audited Five Star Services, Inc., based upon a request from the U.S. Department of Housing and Urban Development's (HUD) Denver Office of Multifamily Housing. The objective of our audit was to determine whether Five Star submitted the required monthly accounting and Section 236 excess income reports to HUD.

What We Found

Five Star did not submit required monthly accounting reports and Section 236 excess income reports to HUD. It submitted monthly accounting reports only when it requested permission to use its reserve for replacement fund. In addition, it did not submit any Section 236 excess income reports to HUD for the 31 months in our review period.

What We Recommend

We recommend that the Director of HUD's Denver Office of Multifamily Housing require Five Star to submit the required monthly accounting reports and outstanding Section 236 excess income reports to HUD and if the required reports

are not submitted, consider rescinding the privilege of retaining future excess income or taking other appropriate administrative action. We also recommend that HUD require Five Star to establish and implement sufficient controls to ensure submission of the required reports.

The Denver Office of Multifamily Housing concurred with the recommendations and provided its management decisions on November 2, 2011.

Auditee's Response

We provided the discussion draft of the audit report to Five Star on October 19, 2011, and requested its comments by November 2, 2011. Five Star did not provide a formal written response, but did concur with the finding and recommendations via e-mail on October 25, 2011.

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BACKGROUND AND OBJECTIVE

Five Star Services, Inc., formerly Hendricks Property Management Corporation, was founded in 1972. It was established as a family corporation to develop, build, and manage government-subsidized properties. The executive offices of Five Star are located in Fargo, ND. Five Star's mission is to address the housing needs and services of its applicants and residents through affordable and competitive rental rates. It began managing the three projects owned by Community Homes, Inc., on April 26, 1991.

Community Homes was established in 1970 as a 501(c)3 nonprofit corporation. Community Homes is jointly owned by five public churches and is governed by a board of directors. Its mission is to extend its joint ministry to care for people with low incomes by offering affordable housing as a "stepping stone" that creates an opportunity to improve lives and families. Community Homes consists of three projects, Phase I, Phase II, and Wahpeton (Phase III). Phases I and II are located in Fargo, ND, and Phase III is located in Wahpeton, ND. Phase I has 88 units, Phase II has 96 units, and Phase III has 95 units. The projects are insured under Section 236 of the National Housing Act.

Community Homes receives subsidy assistance from the U.S. Department of Housing and Urban Development (HUD) to provide housing to eligible low- to moderate-income households. In 2008, 2009, and 2010, Community Homes received more than \$592,000, \$662,000, and \$701,000, respectively, for its Section 8 project-based Housing Assistance Payments program.

The objective of our review was to determine whether Five Star submitted the required monthly accounting and Section 236 excess income reports to HUD.

RESULTS OF AUDIT

Finding: Five Star Did Not Submit Monthly Accounting Reports and Section 236 Excess Income Reports to HUD

Five Star did not submit monthly accounting reports and Section 236 excess income reports to HUD. It did not implement controls to ensure compliance with the reporting requirements. As a result, HUD could not effectively monitor changes or improvements in the financial and management status of the three HUD-insured projects.

Five Star Did Not Submit Required Reports

Five Star did not submit monthly accounting reports and Section 236 excess income reports to HUD. It submitted monthly accounting reports only when it requested permission to use its reserve for replacement fund. Five Star did not submit the monthly accounting reports despite requests by HUD to do so since December 2009. In addition, it did not submit any Section 236 excess income reports to HUD for the 31 months in our review period.

The Five Star's Project Owner's/Management Agent's Certification (form HUD-9839-B) with HUD requires it to comply with HUD handbooks, notices, or other policy directives that relate to the management of the project. HUD Handbook 4370.1, Reviewing Annual and Monthly Financial Reports, requires the submission of monthly accounting reports whenever annual financial statement reviews, onsite management reviews, or other information indicates that the project is experiencing financial or management difficulties. HUD Office of Asset Management Memorandum, dated June 16, 2008, Changes of Submission Process for Form HUD-93104, Monthly Report of Excess Income, Effective September 1, 2008, requires owners and agents to provide copies of each monthly report to the appropriate HUD field office.

Five Star Did Not Implement Controls

Five Star did not implement controls to ensure compliance with reporting requirements. Management officials thought that assigned staff members were completing and submitting the required reports; however, they were not doing so.

HUD Could Not Identify Financial and Management Difficulties

HUD could not effectively monitor changes or improvements in the financial and management status of the three HUD-insured projects. Monthly accounting reports and Section 236 excess income reports are useful tools in evaluating a project's performance and monitoring compliance. They allow HUD to identify questionable disbursements or performance problems in a timely manner so that necessary clarifications or corrective actions can be undertaken to resolve the discrepancies.

Recommendations

We recommend that the Director of HUD's Denver Office of Multifamily Housing require Five Star to

- 1A. Submit the required monthly accounting reports and outstanding Section 236 excess income reports to HUD. If the reports are not submitted as required, HUD should consider rescinding the privilege of retaining future excess income or taking other appropriate administrative action.
- 1B. Establish and implement sufficient controls to ensure that Five Star submits the required reports to HUD.

SCOPE AND METHODOLOGY

Our audit covered the period September 1, 2008, through March 31, 2011. We performed our onsite work from May through July 2011 at Five Star's office located at 3255 43rd Street SW, Fargo, ND, and the project offices located at 702 23rd Street S, Fargo, ND.

To accomplish our objectives, we obtained and became familiar with applicable HUD regulations and guidance, along with Five Star's operations manual and pertinent policies and procedures it used to manage the HUD-insured multifamily projects owned by Community Homes.

To determine whether Five Star was submitting its monthly accounting reports and Section 236 excess income reports to HUD, we interviewed applicable HUD, Five Star, and Community Homes staff. We reviewed related documentation maintained by HUD and Community Homes to verify the submission status of the required reports.

We did not use computer-generated data as audit evidence or to support our audit conclusions. We used source documentation maintained by Five Star in its management, financial, and tenant files for background information and in selecting our samples. All conclusions were based on source documentation reviewed during the audit.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Controls over the accounting and collecting of its tenant accounts receivable.
- Controls over the accounting and tracking of its excessive bad debts.
- Controls to ensure compliance with monthly accounting and Section 236 excess income reporting requirements.

We assessed the relevant controls identified above.

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

Significant Deficiency

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

- Five Star did not implement controls to ensure that it complied with monthly accounting and Section 236 excess income reporting requirements.