



Issue Date November 24, 2010
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Audit Report Number 2011-LA-1003
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TO: Kelly S. Boyer, Director, Los Angeles Office of Multifamily Housing, 9DHML

*Tanya E. Schulze*

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: Naomi Gardens, Arcadia, CA, Did Not Comply With HUD Procurement and Waiting List Requirements

## **HIGHLIGHTS**

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

We audited the Naomi Gardens housing project (project) in response to a congressional request from Representative David Dreier of the 26<sup>th</sup> District of California. The request to review the project was based on a constituent's complaint that alleged the possible misuse of U.S. Department of Housing and Urban Development (HUD) funds, including the award of work to the family members of project employees without seeking proposals from other companies. The constituent later added concerns over waiting list violations and families occupying multiple units. Our objective was to determine whether the project was operated in accordance with HUD rules and regulations; specifically, whether HUD funds were misused as alleged.

### **What We Found**

The project's expenses were properly authorized and necessary for its operation; however, the project did not adequately support that it conducted procurement activities in accordance with HUD requirements. As a result, it did not ensure that it paid at least

\$170,916 to contractors and suppliers at a reasonable cost and in accordance with HUD rules and regulations.

The project also did not properly maintain and administer its waiting list. It skipped over eligible applicants on its waiting list to accommodate other applicants without proper justification, allowed applicants to remain on the waiting list longer than HUD rules and regulations allowed, and improperly allowed household member to transfer to additional units. Therefore, the project provided no assurance that tenants were properly admitted to the project in a fair and equitable manner.

### **What We Recommend**

We recommend that the Director of HUD's Los Angeles Office of Multifamily Housing, require the project to (1) implement additional procurement procedures and controls to ensure compliance with HUD handbook requirements, (2) follow and enforce its tenant selection plan and submit documentation to HUD showing that future waiting list pulls have been conducted according to its tenant selection plan, (3) maintain a transfer waiting list for current tenants, and (4) amend the tenant selection plan to clarify and address the transfer of household members into additional units.

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

### **Auditee's Response**

We provided the project a discussion draft report on November 3, 2010, and held an exit conference with project officials on November 10, 2010. The project provided written comments on November 17, 2010, and generally agreed with our findings.

The complete text of the auditee's response can be found in appendix A of this report.

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## **BACKGROUND AND OBJECTIVE**

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The Naomi Gardens housing project (project) is located in Arcadia, CA. The project is owned by California Trinity Housing, Inc., located in Atlanta, GA, and operated by an independent management agent, ManSerMar, Inc. (agent), located in Duluth, GA. The project is designated as a Section 202 senior project that was granted occupancy after 1981. It is designed to serve persons 62 years of age or older, with 10 percent of its units set aside for persons 18 years of age and older who are physically disabled and require units that have accessible design features. The project has 100 1-bedroom units under a Section 8 housing assistance payments contract with the U.S. Department of Housing and Urban Development (HUD).

The Section 202 program provides direct Federal loans for a maximum term of 40 years under Section 202 of the Housing Act of 1959, as amended, to assist private, nonprofit corporations and consumer cooperatives in the development of new or substantially rehabilitated housing and related facilities to serve the elderly, physically handicapped, developmentally disabled or chronically mentally ill adults. The Section 8 program provides federally funded housing assistance payments to very low-income families and elderly and disabled households.

Representative David Dreier of the 26<sup>th</sup> District of California submitted a constituent's complaint that alleged the possible misuse of U.S. Department of Housing and Urban Development (HUD) funds, including the award of work to the family members of project employees without seeking proposals from other companies. The constituent later added concerns over waiting list violations and families occupying multiple units.

Our objective was to determine whether the project was operated in accordance with HUD rules and regulations; specifically, whether HUD funds were misused as alleged.

## RESULTS OF AUDIT

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### Finding 1: The Project Did Not Adequately Support Its Procurement Activities

The project procured professional services and awarded contracts without properly soliciting bids or obtaining oral or written cost estimates and did not maintain procurement records as required by HUD regulations. This condition occurred due to the project's lack of written policies and procedures before March 2010. Further, current policies and procedures lacked sufficient details to ensure compliance with HUD rules and regulations. As a result, the project paid at least \$170,916 to contractors and suppliers without adequate support to show whether the services were performed at a reasonable cost.

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#### **Prudent Procurement Practices Were Not Followed**

The project did not obtain the required number of bids before awarding contracts. HUD Handbook 4381.5, paragraph 6.50(a), requires the solicitation of written cost estimates from at least three contractors or suppliers for any contract, ongoing supplies, and services expected to exceed \$10,000 per year. However, the project only obtained two bids before awarding two contracts in 2009 for painting and awning services. Further, it was unable to provide documentation showing that bids were obtained from three other contractors that performed air conditioning, landscaping, and floor installation services (see appendix C for details). In each case, the amount paid exceeded \$10,000 for calendar year 2009 and/or 2010 (or was on track to exceed this amount for 2010 as of May 2010).

Further, the project did not document that it obtained cost estimates for the two vendors used for ongoing supplies that exceeded \$5,000 per year (see appendix C). HUD Handbook 4381.5, paragraph 6.50(b), requires that for any contract, 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 obtains services, supplies, and purchases at the lowest possible cost. Although the handbook is silent concerning expenditures between \$5,000 and \$10,000, in the absence of more stringent project policies, this criteria remains applicable as the minimum procurement requirement.

#### **Procurement Documents Were Not Retained**

The project was unable to provide documentation showing that bidding was performed for the continuing air conditioning and landscaping services contracts. Specifically, the

project's compliance officer stated that HUD rules and regulations only required the project to keep records for 3 years; and since the vendors had been in use for over 3 years, the project did not have to maintain documentation showing the bidding that was performed. However, HUD Handbook 4381.5, paragraph 6.50(c), states that documentation of all bids should be retained as part of the project's records for 3 years following the completion of the work. Consequently, since the project continued to extend its contracts with the two vendors in question, and the work was never completed within the context of the handbook requirements, all records of bids should have been retained.

In addition, the onsite staff claimed to have called for estimates on the supply services vendors that were paid more than \$5,000 but did not document the price quotes to justify the use of those vendors.

### **The Project Did Not Have Adequate Written Policies and Procedures**

We attribute the above deficiencies to the project's lack of written policies and procedures before March 2010. Although policies and procedures have since been established, the project's updated procurement policy did not provide details related to the bidding threshold. The agent's procurement procedure also did not provide details related to the bidding threshold. Instead, it merely stated that a major report or improvement that was not routine in nature in excess of \$5,000 required owner approval.

### **Conclusion**

The project violated HUD procurement requirements. This condition occurred because the project did not have written procurement procedures in place before March 2010. Further, although written procurement policies have since been established, they did not provide details related to the bidding threshold. Additionally, there were no controls in place to ensure the implementation of the new procurement policies. As a result, the project paid at least \$170,916 to contractors and suppliers without adequate support to show whether the services were performed at a reasonable cost and in accordance with HUD rules and regulations. Although the project did not support its procurement activities, since the payments were made to unrelated third-party vendors and it did not appear that the potential overpayments on amounts expended would be material, we do not believe it is necessary for the project to demonstrate their reasonableness to HUD. However, we recommend that the project implement and follow procurement procedures to ensure that all expenditures are performed at a reasonable cost and HUD funds are spent accordingly.

## Recommendations

We recommend that the Director of HUD's Los Angeles Office of Multifamily Housing require the project to

- 1A. Implement additional procurement procedures and controls to ensure compliance with HUD Handbook 4381.5, paragraphs 6.50(a), (b), and (c), regarding soliciting cost estimates, soliciting bids, obtaining and retaining written cost estimates, and documenting the reasons for the selection of other than the lowest bidder.

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## Finding 2: The Project Did Not Maintain and Administer Its Waiting List in Accordance With HUD Rules and Regulations

The project did not follow the waiting list policies and procedures required in the tenant selection plan. The waiting list was not maintained in accordance with the tenant selection plan, and tenants were selected out of order. Additionally, the project improperly transferred household members to additional units. The waiting list violations were a result of the project's lack of internal controls. As a result, the project selected applicants out of order, applicants remained on the waiting list longer than rules and regulations allowed, and there was no assurance that tenants were properly admitted to the project in a fair and equitable manner.

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### **The Waiting List Was Improperly Administered**

The project skipped over eligible applicants on its waiting list to accommodate other applicants without proper justification. One to four people were skipped each time. The actions of the project denied the applicants who had been on the list the longest immediate Section 202/8 housing and inappropriately allowed other families to receive housing ahead of these applicants.

In addition, this practice of skipping applicants allowed applicants to remain on the waiting list longer than HUD rules and regulations allowed under waiting list removal requirements. HUD Handbook 4350.3 and the project's tenant selection plan state that once an applicant is offered and rejects two units in the property, the applicant must be removed from the waiting list. Three applicants were allowed to remain on the waiting list and remained next on the list to be offered a unit, although they had already rejected a unit twice. Further, one of these applicants was essentially allowed to remain on hold while residing out of the area, as multiple units were offered to other applicants while this applicant was bypassed and remained on the waiting list. The onsite project manager conducted all selections from the waiting list without supervision from the agent. As a result, we attribute these deficiencies to the lack of internal control over the waiting list.

### **Household Members Improperly Transferred to Additional Units**

The project improperly allowed the spouses of two tenants to transfer into additional units. In one case, the applicant was the mother-in-law of the onsite manager. In the other instance, the separation documents were not current or official. According to the tenant selection plan, transfers may be granted for medical reasons certified by a medical doctor, to gain access to a needed handicap accessible unit or to resolve tenant disputes.

These transfers have priority over the waiting list. However, the project failed to maintain a transfer waiting list as required by HUD rules and regulations and the project's tenant selection plan. In addition, by transferring these tenants instead of requiring them to apply for another unit, eligible applicants on the waiting list had to wait longer than they should have. If the project intends to allow these types of requested transfers, they should amend the tenant selection plan to address this issue to prevent the appearance of favoritism.

## **Conclusion**

The project did not provide equitable consideration and provided no assurance that tenants were properly admitted to the project in a fair and equitable manner. A lack of internal controls allowed the project to select applicants out of order on the waiting list. The project could maintain fairness and equality in the waiting list selection process by ensuring that policies and procedures are followed and reflect the most current housing needs.

## **Recommendations**

We recommend that the Director of HUD's Los Angeles Office of Multifamily Housing require the project to

- 2A. Implement additional procedures and controls to ensure that future waiting list pulls are conducted in accordance with its tenant selection plan.
- 2B. Implement and maintain a waiting list for all current tenants that request to transfer to other units to ensure compliance with the tenant selection plan.
- 2C. Amend the tenant selection plan to clarify whether the transfer of individual household members into new units is considered a transfer or whether the individual is required to apply for a unit and go through the waiting list process.

## SCOPE AND METHODOLOGY

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We performed our onsite audit work at the project, located in Arcadia, CA, between June and September 2010. Our audit generally covered the period January 1, 2009, through May 31, 2010.

To accomplish our audit objectives, we

- Reviewed applicable HUD regulations, including the Occupancy Requirements of Subsidized Multifamily Housing Programs, HUD Handbook 4350.3, and the Management Agent Handbook 4381.5.
- Reviewed the project's tenant selection plan and internal policies and procedures.
- Interviewed personnel from the HUD Los Angeles Office of Multifamily Housing.
- Interviewed the project's management and staff to determine their job responsibilities and understanding of waiting list administration and procurement practices.
- Reviewed the project's general ledger and expenses reports.
  - The total amount of expenditures between January 1, 2009, and May 31, 2010, was just under \$2 million. We selected the top 15 expense accounts for disbursements between January 1, 2009, and May 31, 2010. We removed the following expenditures that were considered low risk:
    - Interest on mortgage payment
    - Current depreciation
    - Property and liability insurance
    - Electricity
    - Employee medical insurance
    - Payroll taxes
  - From the nine remaining expense accounts (totaling \$44,004), we selected invoices with the highest disbursement amounts.
    - We also reviewed disbursements for indications that relatives of employees were paid for working at the facility and interviewed project staff on the matter, but found no evidence any such material amounts were paid by the project.
- Reviewed tenant files to determine whether the project followed HUD rules and regulations in determining tenant eligibility and rent calculations, including household members that transferred to additional units.
  - For our review, we looked at the universe of all units and tenants that received housing assistance payments from January 1, 2009, to May 31, 2010. There was a total of 112 tenants during this period.

- We nonstatistically selected three tenants as follows: a tenant who moved out during our audit period, a tenant who moved in during our audit period, and one existing tenant who did not move in or out during our audit period.
- Reviewed the project's waiting list and applicant files.
  - For our review of the waiting list, we looked at the current active waiting list from May 9, 2006, to February 22, 2010. There was a total of 70 applicants on the waiting list, including inactive applicants.
  - For our review of applicant files, we nonstatistically selected our sample from the waiting list to include at least one active applicant and one applicant that had been removed. We ultimately reviewed three applicants.

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 audit 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 controls were relevant to our audit objective:

- Policies and procedures that management has implemented to ensure that HUD funds are expended in accordance with HUD rules and regulations.
- Policies and procedures for the waiting list that management has implemented to reasonably ensure compliance with HUD rules and regulations.

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 Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- The project's procurement policies and procedures were inadequate to ensure that HUD funds were expended in compliance with HUD rules and regulations (finding 1).
- The project lacked controls to ensure that the waiting list was administered in accordance with HUD rules and regulations (finding 2).

# APPENDIXES

## Appendix A

### AUDITEE COMMENTS

#### Auditee Comments

**M**LANSERMAR

November 16, 2010

Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
Region IX  
611 West Sixth Street, Suite 1160  
Los Angeles, California 90017-3101  
Attention:  
Ms. Tanya Schulze

In Re: Naomi Gardens housing project

Dear Ms. Schulze:

In regards to finding number 1 identified in the audit report provided by the Office of the Inspector General as to the procurement policies and procedures, the company updated its written procurement procedures in March, 2010. These written procedures provided more detail direction to employees on the procurement policies that were to be followed by personnel. However, as a result of the audit, the company is currently in the process of amending the written procedures dated March, 2010 to insure the policies sufficiently detail procedures and retention of documents to insure compliance with HUD Handbook 4381.5 paragraph 6.50 (c). As a part of this amendment the policy will also emphasize that documentation be retained for 3 years after completion of work, not simply for 3 years to insure adequate documentation exists to support procurement procedures followed by personnel complied with all HUD regulations. In addition, even while the company is in the process of rewriting these policies, the company is currently requiring quotes, as specified by HUD guidelines, for any contractors and suppliers used which meet the thresholds as identified in HUD Handbook 4381.5 REV-2, section 6.5, even if these were vendors quoted in prior years. This is being implemented to insure that sufficient documentation exists in the company's file to support the fact that all contracts and supplies are obtained at a reasonable cost in accordance with HUD regulations. The company is requiring that these quotes be maintained in the company files and that Property Managers insure that these quotes are current and in the file prior to approving purchase orders submitted for approval by the on-site managers.

This procedure should provide sufficient documentation to adequately support that the company's procurement activities comply with HUD guidelines in the future.

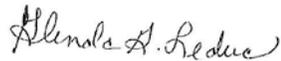
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Page Two

In regards to finding number 2 identified in the audit report, the company immediately reprimanded staff for not complying with the company's existing tenant selection plan. In addition, the company now requires that On-Site Managers must send a copy of the waiting list to the Property Manager prior to moving a new resident in and the Property Manager must grant the On-Site Manager approval before the On-Site manager can move a resident in. The Property Managers are to review the waiting list to insure that the On-Site Manager is complying with the tenant selection plan. In addition, the sites maintain a transfer waiting list. Furthermore, the Tenant Selection Plan has been amended to clarify whether the transfer of individual household members into new units is considered a transfer or whether the individual is required to go through the waiting list process. Currently, a copy of the waiting list or the transfer waiting list including the applications as appropriate is to be retained in the resident's file and this is to be retained for at least 3 years after the move out of the resident. These procedures should provide assurance and documentation needed to support that residents were admitted in a fair and equitable manner.

Should any additional information be needed or additional action required, please contact us.

Sincerely,



Glenda G. Leduc  
President  
Mansermar, Inc.

## Appendix B

### CRITERIA

**HUD Handbook 4350.3, Occupancy Requirements of Subsidized Multifamily Housing Programs; Chapter 4, Waiting List and Tenant Selection; Section 3, Waiting List Management; paragraph 4-20, Removing Names from the Waiting List,** states that the owner must document removal of any names from the waiting list with the time and date of the removal.

A. The tenant selection plan must include a written policy that describes when applicant names will be removed from the waiting list. Examples of applicant removal policies an owner may adopt are:

1. The applicant no longer meets the eligibility requirements for the property or program;
2. The applicant fails to respond to a written notice for an eligibility interview;
3. The applicant is offered and rejects two units in the property (or any number of unit offers as specified in the owner's written policies);
4. Mail sent to the applicant's address is returned as undeliverable; or
5. The unit that is needed – using family size as the basis – changes, and no appropriate size unit exists in the property.

**HUD Handbook 4350.3, Occupancy Requirements of Subsidized Multifamily Housing Programs; Chapter 4, Waiting List and Tenant Selection; Section 4, Selecting Tenants from the Waiting List; paragraph 4-23, General**

A. Once an owner has solicited applications and developed a waiting list for applicants for whom no unit is immediately available, the owner must select applicants from the waiting list and offer units in the order required by HUD rules and owner policies. This section describes options for the owner and provides guidance on how to carry out these activities.

B. When a unit becomes vacant, the owner must select the next applicant from the waiting list based on the unit size available, preferences established for the property, income-targeting policies and requirements, and screening policies applied by the owner. The owner will select the first name on the waiting list for the appropriate unit size (or list of names for units reserved for disabled applicants) and make a final determination of eligibility and suitability for tenancy, using the criteria described in Chapter 3, Sections 1 and 2, and the procedures in this section.

**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, ongoing supplies, and services expected to exceed \$10,000 per year. **Paragraph 6.50(b)** provides that for any contract, 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. **Paragraph 6.50(c)** states that documentation of all bids should be retained as a part of the project's records for three years following the completion of the work.

**Tenant Selection Plan, Waiting List:** Accessible units will first be offered to current tenants requiring the accessibility features of the unit. Then, management must offer the unit to a qualified applicant on the waiting list who has a physical impairment requiring the accessibility features of the unit. When neither a current tenant nor qualified applicant with disabilities in need of a unit with accessibility features is available, management may offer the unit to a non-disabled applicant. The non-disabled applicant must sign an agreement to move to a typical unit when one becomes available, or when the accessible unit is needed to house a physically impaired applicant.

If there are no transfer requests, the unit will be offered to the household at the top of the waiting list for that unit type. If the household cannot be contacted within four working days, the offer will be canceled and the unit will be offered to the next applicant on the waiting list.

In that event, the first applicant will be sent a letter requesting confirmation of its interest in remaining on the waiting list. If no reply is received within 14 days, the application will be withdrawn from the list. If applicant cannot move into unit at the time of offer but wishes to remain on the waiting list, they will retain their position on list. After two offers of housing and refusal, for any reason, the applicant will be removed from the waiting list and the application will be cancelled. A letter will be sent confirming their cancellation of application.

**Tenant Selection Plan, Transfers:** A waiting list of residents that request to transfer into another unit must be maintained by management. In house transfers are given priority before applicants on the waiting list. Tenants will be placed on transfer waiting list according to date and time of the request. Factors concerning transfers include a transfer for a medical reason certified by a medical doctor, based on the need for an accessible unit/features, and to resolve resident disputes. Residents will be responsible for personal moving costs associated with the transfer.

**Tenant Selection Plan, Removal of Applicants from the Waiting List:** Applicants may be removed if: they request to be removed; they were clearly advised of the requirement to tell management of his/her continued interest in housing by a particular time and failed to do so; they fail to respond to a written notice of eligibility; they are offered and reject two units in the property; mail sent is returned undeliverable; the unit size that is needed does not exist in the property; they fail to move in on agreed upon date; or they fail to contact management, in writing, every six months of intent to stay on waiting list. If this occurs the application will be cancelled and removed from the list and unit will be offered to next applicant.

## Appendix C

### SCHEDULE OF PROCUREMENT REVIEW RESULTS

Vendor	Compliance with HUD Handbook 4381.5			Expenses not properly procured		
	Section 6.50(a)	Section 6.50(b)	Section 6.50(c)	2009	2010	Totals
Pacific Painting	No	N/A	Yes	\$49,964	\$ -	\$49,964
Superior Awning	No	N/A	Yes	-	10,226	\$ 10,226
California Air Conditioning Services	No	N/A	No	18,004	6,497	\$ 24,501
Stonetree Landscape	No	N/A	No	27,316	7,458	\$ 34,774
HD Facilities Supplies	N/A**	No	N/A	17,887	6,976	\$ 24,863
Perfect Floors	No	N/A	No	11,142	5,067	\$ 16,209
Orchard Supply	N/A**	No	N/A	10,379	-	\$10,379
<b>Total expenses not properly procured</b>						<b>\$170,916</b>

\*\* Although amounts paid to these vendors exceeded \$10,000 in 2009, since the supply items purchased were dissimilar and generally purchased as needed, we only held the project to the section 6.50(b) requirements.