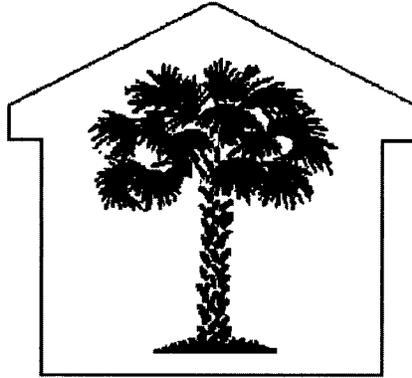


*South Carolina State Housing Finance and Development  
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**CPM Class of 2004 Project:**

***Auditing the Auditor***

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SC State Housing Finance and Development Authority

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## Executive Summary

The South Carolina State Housing Finance and Development Authority performs audits of subsidized multifamily apartment complexes across the state. A team of eleven auditors (Asset Managers) within the agency's Contract Administration division is charged with the task of performing these audits (Management and Occupancy Reviews). Management and Occupancy Reviews are in effect compliance audits that are broken into six areas of concentration. The reviews are conducted based on general guidance from the Department of Housing and Urban Development. Assets Managers review each of the six areas of concentration and derive an overall rating for each property. The purpose of this project is to develop a system of determining the relative importance of each audit section to the overall rating of the property. In addition, the research will address concerns related to the consistency and fairness of the review process.

# Table of Contents

|      |                          |    |
|------|--------------------------|----|
| I.   | The Problem.....         | 4  |
| II.  | Data Collection.....     | 5  |
| III. | Data Analysis.....       | 6  |
| IV.  | Implementation Plan..... | 9  |
| V.   | Evaluation.....          | 12 |
| VI.  | Appendix.....            | 13 |

## Chapter I

### The Problem

The South Carolina State Housing Finance and Development Authority under contract with the federal government performs audits and support functions for approximately 300 subsidized properties across the state. The work is completed under a performance based contract which requires that 16 core tasks be completed accurately and within the time frames established in the contract. Audits are performed annually on each property. The audit rating is determined by completing a review process that culminates in the completion of the HUD form 9834 (Appendix). The form 9834 has six parts and an overall rating. The six sections are:

- Maintenance and Security
- Financial Management
- Leasing and Occupancy
- Tenant Management Relations
- Drug Free Housing
- General Management Practices

Auditors rate each individual section, either, Superior, Satisfactory, Below Average or Unsatisfactory. The auditor must then select an overall rating based on the same classifications. The HUD handbook does not provide a weighting methodology for determining the overall rating. The guidebook does however indicate that two sections should be emphasized. The sections are Maintenance and Security and Leasing and Occupancy. The guidebook also stipulates that the overall rating should match the rating given to at least one of the areas of emphasis. Beyond this information the guidebook gives no guidance as to the relative importance of each section to the overall property rating. The problem arises from at least the appearance of inconsistencies within ratings. In addition properties vary widely as to year of construction. The concern is that esthetics resulting from older designs can possibly bias the auditor toward lower ratings for older properties. Auditors also establish relationships with management agents based on both positive and negative experiences. Problems may potentially arise based on an auditor rating a management company in general instead of rating a specific property.

## Chapter II

### Data Collection

We surveyed each of the eleven auditors (termed Asset Managers), and asked that they provide a weighting methodology for the audit form 9834 (Appendix “Management and Occupancy Review Survey of Asset Managers”). Each asset manager assigned a weighting percentage for each of the six sections of the form 9834 based on their perception of that sections relative importance in deriving an overall rating. In addition we counted the number of questions in each section of the 9834 to try and gain an understanding of the importance that HUD placed on each of the sections. We also gathered data from 693 audits that included the following:

Auditor Name  
Property Name  
Property Age  
Management Agent

## Chapter III

### Data Analysis

In reference to the problem related to the form 9834, each of the eleven auditors provided a weighting percentage for each of the six categories based on their understanding of the relative importance of each category. The average of the responses was reported in Chart 1. The weighting methodology calculated as a percentage of questions in each portion of the form 9834 is presented for comparison.

Chart 1

|                              | Average | As %<br>of Questions | Difference |
|------------------------------|---------|----------------------|------------|
| Maintenance and Security     | 28%     | 35%                  | 7%         |
| Financial Management         | 8%      | 5%                   | 3%         |
| Leasing and Occupancy        | 33%     | 40%                  | 7%         |
| Tenant Management Relations  | 9%      | 5%                   | 4%         |
| Drug Free Housing            | 9%      | 5%                   | 4%         |
| General Management Practices | 13%     | 10%                  | 3%         |

The team of Asset Managers concluded that their individual ratings while well thought out were in fact somewhat arbitrary. The team understands that the audit process cannot be completed mechanically. The process is indeed both art and science. Bearing this in mind the data demonstrated that the average

weightings of each of the Asset Managers was similar to the mechanical derivation based on the number of questions in each section of the form 9834.

In reference to the hypothesis that age alone can negatively impact ratings, audits were separated based on the HUD database date for initial occupancy. Properties that were initially occupied in 1980 or earlier were categorized as “older properties.” Properties initially occupied after 1980 were categorized as “newer properties.”

Audit findings are reported in Chart 2.

Chart 2

|                | Older Properties | Newer Properties |
|----------------|------------------|------------------|
| Superior       | 14%              | 39%              |
| Satisfactory   | 77%              | 59%              |
| Below Average  | 6%               | 2%               |
| Unsatisfactory | 3%               | 0%               |

There are issues inherent to older properties such as the potential for a greater amount of deferred maintenance. However the data seems to indicate a bias against awarding an older property a Superior rating. In addition 9% of the older properties received ratings of less than Satisfactory as compared to the newer properties 2%.

In order to test the hypothesis that auditors may tend to rate properties with bias based on an auditor’s previous experience with a particular management agent I reviewed the audits of two management agent’s portfolios. Forty-five audits were performed within the two portfolios. This hypothesis was formulated to address specific questions of fairness from the two management agents. The first portfolio reviewed revealed ratings that were overall more favorable than the ratings of the total population. Review of the second portfolio revealed ratings less favorable than the general population. Further

review indicated that different auditors were consistent in their assessment of this portfolio. Furthermore the lower ratings within the second portfolio were assessed by one of three senior auditors. Analysis of the data reported in Chart 3 does not indicate that auditors are demonstrating audit bias based on previous experience with management agents.

Chart 3

|                | Total Population | Subject #1 | Subject #2 |
|----------------|------------------|------------|------------|
| Superior       | 25%              | 31%        | 5%         |
| Satisfactory   | 69%              | 50%        | 79%        |
| Below Average  | 4%               | 15%        | 16%        |
| Unsatisfactory | 2%               | 4%         | 0%         |

## Chapter IV

### Implementation Plan

The primary focus of the implementation plan will involve the use of the Management and Occupancy Review Analysis worksheet. The staff member responsible for the initial review of the HUD Form 9834 will input audit ratings for each audit category. The mathematical equivalent of each rating has been established as follows:

|                |   |
|----------------|---|
| Superior       | 4 |
| Satisfactory   | 3 |
| Below Average  | 2 |
| Unsatisfactory | 1 |

The worksheet will calculate an overall rating based on the weighting derived from the compilation of the number of questions in each section of the form 9834. The “Weighted Scores Test” column will calculate the difference between the weighted score and the overall score assigned by the auditor. If the absolute value of the difference is  $\leq .5$  the test column will return “OK”. If the absolute value is  $> .5$  the test column will return “ERROR”. The acceptable deviation of .5 will be evaluated to determine its effectiveness. The “Major Category Test” column checks for a match between, either the Maintenance and Security or the Leasing and Occupancy categories, and the overall rating. A match in either category will return a value of 1. If the sum of the “Major Category Test” column is  $\geq 1$  this will indicate at least one match and return “OK”. In the event that either test column indicates an error the Management and Occupancy Review will be returned to the auditor for additional review. In the event that the additional review does not result in changes, the review will be assessed by senior audit staff. Senior audit staff can either approve the rating or recommend adjustments.

# Management and Occupancy Review Analysis Worksheet

|                              | Rating   | Weighted Scores Test | Major Category Test |
|------------------------------|----------|----------------------|---------------------|
| Maintenance And Security     | 2        | 0.7                  | 1                   |
| Financial Management         | 4        | 0.2                  |                     |
| Leasing And Occupancy        | 3        | 1.2                  | 0                   |
| Tenant Management Relations  | 3        | 0.15                 |                     |
| Drug Free Housing            | 2        | 0.1                  |                     |
| General Management Practices | 1        | 0.1                  |                     |
| <b>Total Rating</b>          | <b>2</b> | <b>2.45</b>          | <b>1</b>            |
|                              |          | <b>OK</b>            | <b>OK</b>           |

- Superior 4**
- Satisfactory 3**
- Below Average 2**
- Unsatisfactory 1**

In reference to audit bias based on the age of the property the implementation phase of the process will involve the communication of the data to audit staff indicating the bias. Staff will be instructed not to consider outdated architecture or choice of building materials when making an assessment of the property. Staff will be advised to focus on issues within the control of the current owner/agent.

In reference to the potential to perform property audits with bias based on prior experience with owner/agents, auditors will be instructed to allow owner/agents the “benefit of the doubt” when assessing each property. Staff will be commended on overall consistency and professionalism but reminded that fairness will always be questioned in relation to subjective processes.

## Chapter V

### Evaluation

The fact that Contract Administration staff analyzed audit findings for consistency and fairness will be communicated to our housing partners to include HUD staff and owner/agents. A periodic review of audit statistics will be undertaken to help educate staff and build confidence in our agency within the housing community. The tools for analysis created during this process can be used in future assessments of consistency and fairness. In the end however, there is no substitute for an auditor's professional judgment. We should however, take advantage of each opportunity to provide tools for objective quantifiable property evaluations.

## Chapter VI Appendix

|   |                     |                |                         |
|---|---------------------|----------------|-------------------------|
| Section 8 Number                                    | Section of the Act: | Name of Owner: | Date of Report:         |
| Project Status:<br>Insured X HUD-Held 0 Non-Insured |                     |                | No. of Units Inspected: |

|  |                                     |
|--|-------------------------------------|
| Report Based On:<br>0 HUD Occupancy Review Date:<br>[~ On-Site Interview with<br>•I Visited Agent's Office with: | Name of Management Agent:           |
| Project Name & Address:  | Management Term (mm/dd/yy):<br>thru |
|  | Name of Resident Manager:           |
|  | Date Hired':                        |

|  |   |   |   |     |   |   |   |   |     |
|--|---|---|---|-----|---|---|---|---|-----|
| A. Maintenance & Security  | A | M | I | TCD | 22. Tenant Files and Records  |   |   |   |     |
| 1. General Physical Condition  |   |   |   |     | III. Leasing and Occupancy Rating<br>0 Superior N Satisfactory<br>00 Below Average Unsatisfactory           |   |   |   |     |
| 2. Work Scheduling   |   |   |   |     |   |   |   |   |     |
| 3. Preventative Maintenance  |   |   |   |     |   |   |   |   |     |
| 4. Unit Inspections  |   |   |   |     |   |   |   |   |     |
| 5. Vacant Unit Preparation   |   |   |   |     | D. Tenant/Management Relations  | A | M | I |     |
| 6. Equipment and Inventory Controls  |   |   |   |     | 23. <u>Tenant Participation</u>   |   |   |   |     |
| 7. Procurement and Supply Practices  |   |   |   |     | 24. Provision of Tenant Services  |   |   |   |     |
| 8. Security Program  |   |   |   |     | 25. Use of Community Space  |   |   |   |     |
| 9. Energy Conservation   |   |   |   |     | 26. Tenant Satisfaction   |   |   |   |     |
| I. Maintenance and Security Rating<br>0 Superior i0 Satisfactory<br>0 Below Average 0 Unsatisfactory |   |   |   |     | IV. Tenant/Management Relations Ratings<br>ID Superior */ Satisfactory<br>0 Below Average 0 Unsatisfactory  |   |   |   |     |
| B. Financial Management  | A | M | I | TCD | E. Drug-Free Housing Policy   | A | M | I | TCD |
| 10. Budget Management  |   |   |   |     | 27. Uniform, Written Tenant Selection Plans That Aid And Support Drug-Free Housing.                         |   |   |   |     |
| 11. Submission of Reports  |   |   |   |     | 28. House Rules That Aid And Support Drug Free Housing.   |   |   |   |     |
| 12. Rental Collection  |   |   |   |     | 29. Evidence of Drug Use/Sales at Project   |   |   |   |     |
| 13. Fee Collection Practices   |   |   |   |     | 30. Overall Project Plan For Drug-Free Housing.   |   |   |   |     |
|  |   |   |   |     | 31. Project Owner/Agent is A Member of Local Drug-Free Housing Task Force (if formed).                      |   |   |   |     |
|  |   |   |   |     | V. <i>Drug-Free</i> Housing Policy Rating<br>01 Superior 0 Satisfactory<br>0 Below Average 0 Unsatisfactory |   |   |   |     |
| II. Financial Management Rating<br>[0] Superior DI Satisfactory<br>Below Average 0 Unsatisfactory    |   |   |   |     | F. General Management Practices   | A | M | I | TCD |
|  |   |   |   |     | 40. Staffing and Personnel Practices  |   |   |   |     |
|  |   |   |   |     | 41. Operating Procedures and Manuals  |   |   |   |     |
| C. Leasing & Occupancy   | A | M | I | TCD | 42. Training  |   |   |   |     |
| 14. Tenant Selection and Orientation   |   |   |   |     | 43. Office Administration   |   |   |   |     |
| 15. Vacancy and Turnover   |   |   |   |     |   |   |   |   |     |
| 16. Leases and Deposits  |   |   |   |     |   |   |   |   |     |
| 17. Rent Schedule Compliance   |   |   |   |     |   |   |   |   |     |
| 18. Application Processing   |   |   |   |     |   |   |   |   |     |
| 19. Recertification System   |   |   |   |     | VI. General Management Practices Rating<br>] Superior [ Satisfactory<br>[•] Below Average [ Unsatisfactory  |   |   |   |     |
| 20. Monthly Vouchers   |   |   |   |     |   |   |   |   |     |
| 21. Eviction Procedures  |   |   |   |     |   |   |   |   |     |

VII. Rating of Overall Management Operation (Mark applicable box): [ ] Superior [ ] Satisfactory [ ] Below Average [ ] Unsatisfactory  
 Signature, Name & Title of Person Preparing this Report & Date: \_\_\_\_\_ Signature, Name & Title of Person Approving this Report & Date: \_\_\_\_\_

Asset Mgr.

Senior Asset Mgr.

# Management and Occupancy Review Survey of Asset Managers:

Responses from Asset Managers as to the importance (Weighting) of each section of the 9834.

|         | 1<br>Maint<br>& Security | 2<br>Financial<br>Mgmt | 3<br>Leasing<br>Occupancy | 4<br>Tenant Mgmt<br>Relations | 5<br>Drug Free<br>Housing | 6<br>Mgmt<br>Practices |
|---------|--------------------------|------------------------|---------------------------|-------------------------------|---------------------------|------------------------|
| Auditor |                          |                        |                           |                               |                           |                        |
| 1       | 0.25                     | 0.1                    | 0.25                      | 0.1                           | 0.15                      | 0.15                   |
| 2       | 0.3                      | 0.05                   | 0.35                      | 0.1                           | 0.1                       | 0.1                    |
| 3       | 0.3                      | 0.02                   | 0.3                       | 0.15                          | 0.1                       | 0.13                   |
| 4       | 0.25                     | 0.1                    | 0.4                       | 0.1                           | 0.05                      | 0.1                    |
| 5       | 0.35                     | 0.05                   | 0.4                       | 0.05                          | 0.05                      | 0.1                    |
| 6       | 0.3                      | 0.02                   | 0.3                       | 0.13                          | 0.11                      | 0.14                   |
| 7       | 0.2                      | 0.15                   | 0.3                       | 0.1                           | 0.1                       | 0.15                   |
| 8       | 0.25                     | 0.15                   | 0.4                       | 0.05                          | 0.05                      | 0.1                    |
| 9       | 0.35                     | 0.1                    | 0.35                      | 0                             | 0                         | 0.2                    |
| 10      | 0.3                      | 0.05                   | 0.35                      | 0.1                           | 0.1                       | 0.1                    |
| 11      | 0.25                     | 0.1                    | 0.25                      | 0.1                           | 0.15                      | 0.15                   |
|         | 3.1                      | 0.89                   | 3.65                      | 0.98                          | 0.96                      | 1.42                   |
| Average | 28.18%                   | 8.09%                  | 33.18%                    | 8.91%                         | 8.73%                     | 12.91%                 |