



City of Phoenix

Mission Statement

To improve the quality of life in Phoenix through efficient delivery of outstanding public services.

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Project Number

1240030

This report can be made available in alternate format upon request.

Housing Department Contract Audit – Dunlap and Magee

September 6, 2024

Report Highlights

Monitoring

Housing staff met with the Contractor monthly to discuss monthly financials. Additional steps are needed to confirm the information provided and monitor performance.

Reporting

Housing did not effectively monitor the Contractor's compliance with contract reporting requirements.

Inspections

Housing did not conduct file and physical inspections as required by the contract.

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Executive Summary

Purpose

Our purpose was to determine if the Housing Department (Housing) had adequate contract monitoring processes to ensure Dunlap & Magee Property Management effectively managed the City's affordable housing properties.

Background

The City currently owns 16 multifamily residential housing properties with 1,219 rental units that provide affordable housing for low to moderate-income tenants overseen by the Housing Department (Housing). The City executed contracts No. 150959, 150960, and 150961 (Affordable Housing Contracts) with Dunlap & Magee Property Management Services Inc. (Contractor) to manage the properties. The Contractor is responsible for the day-to-day operations of the properties, including tenant application qualification, rent collection, rental activity, financial accounting, maintenance, and repairs. In addition to the contracts that govern the Contractor's responsibilities, the Contractor also has a management plan that outlines its goals and operations plans.

The Contractor receives 5.5% of the gross rent receipts collected for managing the properties. The original contracts were effective October 31, 2019, for three years with an option to renew for two additional one-year terms. Two of the contracts' extensions have been exercised and will expire on October 30, 2024. The third contract extension was also exercised and expired on November 5, 2023.

Results in Brief

Housing staff met with the Contractor monthly to discuss monthly financials. Additional steps are needed to confirm the information provided.

Housing held monthly calls with the Contractor to discuss the monthly financial reports provided. Staff maintained an ongoing log to track issues discussed. While this ensures that Housing can follow up on issues identified, Housing needs to confirm the information by collecting and reviewing supporting documents. We found unsupported and inaccurate expenses based on vendor invoices. Further, we found that the management fee was not always calculated accurately.

Processes are needed to ensure the Contractor submits the required reports with all necessary information.

We tested required reports to determine if Housing monitored the Contractor's compliance with the reporting requirements. We noted that reports did not always include the required elements. Housing could not provide information verifying the reports were submitted timely. The Contractor did not submit two of the six required reports in 2023, and two of the four received did not include all the required elements.

Housing did not have policies or procedures for ensuring that reports were complete and received timely.

Housing did not conduct physical inspections of each property at least annually.

We interviewed staff and tested property inspection documents to determine if Housing inspected each property annually according to the physical checklist required by the contracts. Housing did not use the inspection checklist when conducting physical property inspections. Housing did not perform physical property inspections at any of the properties in 2021 due to the pandemic. In 2022, Housing staff conducted 5 of 16 (31%) required physical inspections, and in 2023, it conducted 6 of the required 16 physical inspections (38%). Five properties were not inspected in 2022 or 2023. The inspections completed in 2022 and 2023 did not cover the minimum requirements on the physical inspection list.

Housing did not conduct file inspection reviews of each property at least annually.

We interviewed Housing staff to understand their processes for completing file reviews required by the contracts. Housing conducted file inspection reviews for 3 of the 16 properties between July 1, 2022, and November 30, 2023. Housing did not use the file inspection checklist as required by the contract. As a result, the inspections completed did not encompass all requirements specified in the contract. Not conducting annual file inspections increases the risk of renting affordable housing units to ineligible residents.

Department Responses to Recommendations

<p>Rec. # 1.1: Create written procedures for monitoring contractor compliance with all sections of the Affordable Housing contracts, including processes for:</p> <ul style="list-style-type: none"> • Verifying the accuracy of the Contractor reported rental income, • Ensuring the rental income and security deposit amounts deposited are accurate, • Validating that expenses are accurate and supported, and <p>Following up on discrepancies identified by Finance.</p>	
<p>Response: The Housing Department, Asset Management division, will prepare written procedures for monitoring Contractors' compliance with the terms of the Affordable Housing contracts, including verifying the accuracy of information received from the Contractors.</p>	<p><u>Target Date:</u> 01/31/2025</p>
<p>Explanation, Target Date > 90 Days: Preparation of well-defined written procedures will involve the Housing Department, Asset Management division, engaging with other City departments and potentially external consultants and contractors. Additional time is required to assure that input from these third parties is considered when formulating the new procedures.</p>	
<p>Rec. # 1.2: Document and implement calculation procedures to validate that the monthly management fees the City pays to the Contractor are accurate.</p>	
<p>Response: Housing will modify the terms of existing property management contracts, and will add a provision in contracts going forward, to require that the Contractor provide Housing with a Property Management Fee Calculation Worksheet that documents the calculation of the monthly management fee.</p>	<p><u>Target Date:</u> 01/31/2025</p>
<p>Explanation, Target Date > 90 Days: Preparation of well-defined written procedures will involve the Housing Department, Asset Management division, engaging with other City departments and potentially external consultants and contractors. Additional time is required to assure that input from these third parties is considered when formulating the new procedures.</p>	
<p>Rec. # 2.1: Create and document procedures to ensure the Contractor meets performance requirements and submits required reports on time and with all necessary information.</p>	
<p>Response: The Housing Department, Asset Management division, will implement a report tracking procedure to monitor the Contractors' performance regarding the timely delivery of reports and will ensure all necessary information is included.</p>	<p><u>Target Date:</u> 01/31/2025</p>

Explanation, Target Date > 90 Days: Preparation of well-defined written procedures will involve the Housing Department, Asset Management division, engaging with other City departments and potentially external consultants and contractors. Additional time is required to assure that input from these third parties is considered when formulating the new procedures.

Rec. # 2.2: Work with Novogradac to obtain audited financial statements for fiscal year 2022.

Response: The Housing Department, Asset Management division, will work with Finance to ensure that the external auditor (Novogradac) is receiving the information and feedback it needs to complete and deliver the audited financial statements that are outstanding for fiscal year 2022.

Target Date:
01/31/2025

Explanation, Target Date > 90 Days: The Housing Department, Asset Management division, will engage with Finance and potentially directly with Novogradac, an external contractor, to facilitate the completion of the 2022 audits. Additional time is required since workloads are unknown and are outside the control of Asset Management.

Rec. # 3.1: Create written, well-defined procedures to ensure that physical and file inspections of each property are conducted using the checklist at least annually. The procedures should include timelines and responsible parties.

Response: The Housing Department, Asset Management division, will prepare written procedures covering periodic physical and file inspections of City-owned properties, including the use of appropriate inspection checklists.

Target Date:
01/31/2025

Explanation, Target Date > 90 Days: Preparation of well-defined written procedures will involve the Housing Department, Asset Management division, engaging with other City departments and potentially external consultants and contractors. Additional time is required to assure that input from these third parties is considered when formulating the new procedures.

1 – Financial Monitoring

Background

The Contractor is paid a management fee that is due and payable monthly. The Contractor must adhere to Generally Accepted Accounting Principles (GAAP) and keep and maintain suitable records and receipts pertaining to supervision, management, care, and operation of the properties. The Contractor must submit monthly statements of income and expenses for accounts receivable, accounts payable, receipts, bank statements, and cash flow reports. The Contractor must also submit an annual income and expense budget to Housing for review and approval by May 1st of every year.

The contracts have various restrictions, including no authorizations for advance payments and no payments to the Contractor if there is an outstanding obligation due to the City. As part of its Management Plan, the Contractor also agreed to deposit all security deposits into a separate account from all other funds.

Administrative Regulation (AR) 3.10 – General Procurement Procedures requires departments to monitor contracts and ensure contractors strictly adhere to the agreement requirements. We interviewed Housing staff to determine its processes for monitoring compliance with the contract terms and tested Contractor-submitted budgets, financial statements, bank statements, and invoices to determine the effectiveness of Housing's financial monitoring.

Results

Documented Affordable Housing monitoring procedures are needed to ensure the Contractor meets its obligations.

We interviewed Housing staff to determine if they had documented procedures for monitoring the Affordable Housing contracts. Housing had not created, established, or documented contract monitoring procedures. Without procedures to monitor the Contractor, there is a risk that the Contractor will not adhere to the established terms and conditions in the contract.

Housing held monthly calls with the Contractor to review the monthly financial statements and discuss variances. However, additional steps are needed to ensure accurate rent and security deposits.

Housing holds monthly financial calls with the Contractor to review the financial statements. We interviewed Housing staff and attended a monthly financial call with Housing and the Contractor to understand how Housing monitors and verifies rental income and security deposits.

Housing relied on the Finance Department (Finance) to compare the Contractor's reported rental income and security deposits against the reconciled bank statements monthly to ensure that the amounts were accurate. Finance provides Housing with a

copy of the reconciliations and contacts the Contractor directly when they find variances.

For January and October 2023, we compared the reconciled bank statements to the rent revenue for each property to ensure the amounts matched. Additionally, we checked if the security deposits listed in the monthly financial report were traced to the reconciled bank statements. The reported rental income and security deposits tested did not match the revenue from the reconciled bank statements for each property. Finance staff stated that some discrepancies have taken as long as a year to get corrected by the Contractor.

The Contractor did not comply with the contract requirement to deposit rental revenue and security deposits into separate accounts.

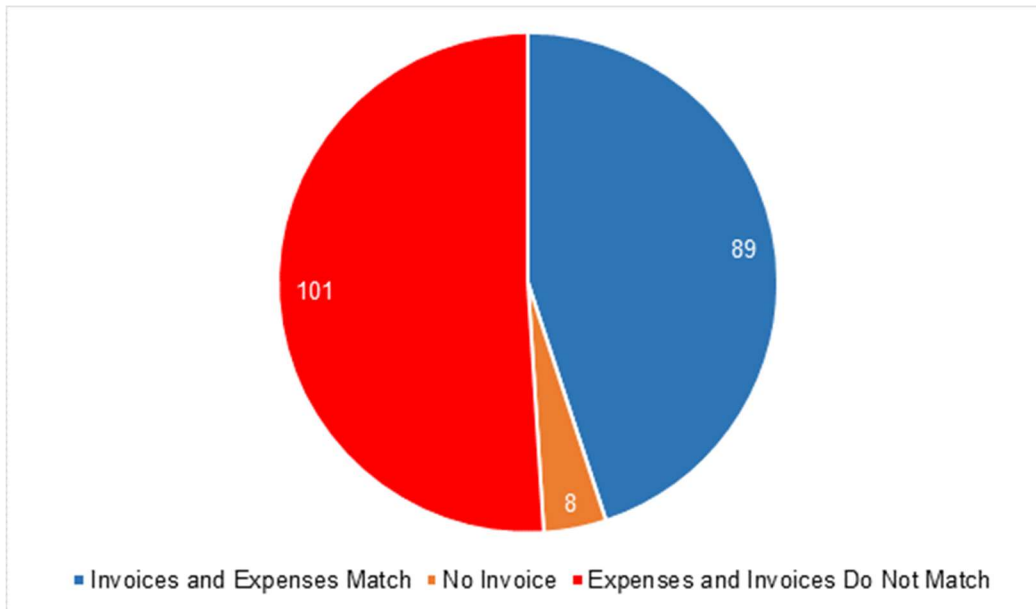
The Contractor did not have a separate account for the security deposits collected as stated in the management plan. Instead, security deposits were deposited into the same account as all other funds. Security deposits are held in trust and should be maintained separate from rent revenue. Housing indicated that having a separate account for security deposits will be required in the upcoming contracts.

Housing did not review invoices from the Contractor to ensure all expenses were supported; expenses and invoices did not match in over half of the transactions we tested.

We interviewed Housing staff and compared invoices for maintenance repairs and replacements to reported expenses for Camelback Properties for June 2023 to determine whether Housing reviews invoices from the Contractor to ensure expenses are supported.

Housing did not review or verify the Contractor's invoices or expenses. We tested 198 reported maintenance repair and replacement transactions.

Invoice and Expenses for Camelback Properties in June 2023



Fifty-five percent of Contractor expenses were unsupported.

Of the 198 reported expenses:

- There were no invoices for eight transactions for approximately \$2,110.
- Recorded transactions for 101 of the expenses did not match the invoices. Errors included inaccurate sales tax, inaccurate vendors or descriptions, incorrect amounts, and incorrect dates recorded.
- 89 of the incorrect transactions recorded had inaccurately applied sales tax, which can lead to overspending and underspending for various line items in the budget.

Reviewing Contractor expenses and invoices ensures that only accurate and allowable expenses are reimbursed.

Controls are needed to verify the accuracy of the management fee payment.

We interviewed Housing staff and reviewed affordable housing contracts to assess the management fees that were allowed. We requested management fee validations for January and October 2023 to determine that Housing verified the accuracy of the payment. We recalculated the management fee due to the amount retained by the Contractor. We also compared the reported total revenue on the City Management Fee Reports (Fee Report) to the actual revenue reported by the Contractor in the monthly financials. We calculated the management fees on the Fee Report and compared the results to the management fees listed in the Contractor-reported monthly financials. We then recalculated the management fees based on total revenue for January and October 2023.

The contract language is contradictory. The contracts allow the Contractor to calculate management fees and pay themselves. However, it also states that no payments may be made to the Contractor if there is an outstanding obligation due to the City.

We noted that the Contractor retained \$1,276.86 more than the allowable amount for management fees in January 2023 and \$618.94 less than the allowable amount in October 2023. The management fees reported by the Contractor on the Fee Reports matched the amounts reported on the monthly financial reports in both months; however, the total revenues did not match. Additionally, the total revenue amounts on the January 2023 Fee Report included vacant residencies and holds as part of the total revenue used to calculate the management fee, even though vacant residencies and holds should not be included as they do not generate revenue. Housing performed a reconciliation of management fee payments for 2023. However they used Contractor-reported information rather than audited financial statements to perform the reconciliation. As a result, the amount of the management fees retained by the Contractor is not compliant with the contract requirements.

Recommendations

- 1.1 Create written procedures for monitoring contractor compliance with all sections of the Affordable Housing contracts, including processes for:
 - Verifying the accuracy of the Contractor reported rental income,
 - Ensuring the rental income and security deposit amounts deposited are accurate,
 - Validating that expenses are accurate and supported, and
 - Following up on discrepancies identified by Finance.
- 1.2 Document and implement calculation procedures to validate that the monthly management fees the City pays to the Contractor are accurate.

2 – Contractor Reporting and Monitoring

Background

The Contractor must submit various reports and meet deliverables and performance metrics throughout the contract term. These reports include a monthly Rent Roll comprised of the Contractor's reported statement of income and expenses, receipts for the preceding month, reconciled bank statements, cash flow reports, work order status reports, payroll breakdowns, unit availability, and prepayment and delinquent rents. The Contractor must also provide weekly narratives, including summaries of move-ins, move-outs, vacancies, evictions, and repairs. Annually, the Contractor must submit fiscal year budgets, five-year capital improvement plans, market analyses, and Fire Life Safety reports for each property.

The Contractor must also provide seven deliverables for Housing to evaluate their performance against the contractual requirements. The deliverables include re-exams/lease renewals, tenant accounts receivables, accounts payables, occupancy, work orders, monthly reports, an annual report, and a financial statement prepared by a CPA.

Housing holds weekly calls with the Contractor to discuss the deliverables and other issues. Housing documents the status of outstanding items identified in a running log to ensure they are remediated.

We interviewed Housing staff to understand their processes for monitoring Contractor performance and reporting. We tested budgets, financial statements, and Contractor submitted reports to determine whether Housing effectively monitored their performance.

Results

Housing ensured that the Contractor submitted the fiscal year budgets.

We tested the budgets for each property for fiscal years 2023 and 2024 by comparing the net income listed on the budgets to the net income on the approval letters. The net income listed on the budgets matched the net income on the approval letters. However, we could not verify if the budgets were submitted timely because Housing did not document the date they received them.

Controls are needed to ensure the Contractor complies with the contract reporting requirements.

We reviewed the affordable housing contracts to establish what reports the Contractor is required to submit to Housing. We tested the Rent Roll and Weekly Narrative reports submitted in January and October 2023 to determine if Housing verified that the Contractor included all required elements. The 5-Year Capital Improvement Plans, Market Analysis, and Fire and Life Safety reports we tested were due in 2022 and 2023.

Contractor Required Reporting

Required Report	Includes All Required Elements	Timely
Rent Roll	No	Unknown
Weekly Narratives	No	Yes
FY Budgets	Yes	Unknown
5-Year Capital Imp Plans	Yes	Unknown
Market Analysis	Not completed	No
Fire and Life Safety Reports	Not completed	No

Contractor reports did not always include all required elements.

The reports did not always include the required elements and did not include review dates. Housing could not confirm the Contractor submitted the reports by the due date. The Contractor has not submitted a Market Analysis report since 2022, and Housing did not require them to submit Fire and Life Safety reports. Instead, the Contractor submitted a Fire/Safety schedule to show when inspections were completed. Housing did not have policies or procedures to ensure that reports contained all required information and were on time.

Housing needs a documented process to ensure the Contractor meets its performance requirements.

We interviewed Housing staff to determine how they ensured the Contractor met the deliverables and performance requirements stipulated in the contract. The City may impose liquidated damages after one warning if the Contractor completes less than 95% of re-exams/lease renewals before the resident’s contract expires.

Contractor Deliverables and Performance Requirements

Deliverable	Performance Requirements	Received from Contractor	Measured by Housing
Re-Exams/Lease Renewal	On-time 95%	Yes	No
Accounts Payable	<0.75% = full performance <1.5% = minimum Measured monthly	Yes	No
Occupancy	>98% = full performance >97% = minimum	Yes	No
Tenants Accounts Receivable	<1.5% = full performance 2.5% = minimum Measured monthly	No	No
Work Orders	Average turn-around not to exceed three days, measured monthly	No	No
Annual Audited Statements	By July 31 each year	2021 – Yes 2022 – No	No
Monthly Report	By the 15 th of the following month	Yes	Yes

Housing did not measure the Contractor’s performance on the deliverables.

Housing did not require the Contractor to provide documentation for two deliverables. Housing did not verify the accuracy of the accounts payable, tenant account receivables, or work orders or determine whether they met measurable performance requirements. Although Housing held weekly calls with the Contractor to discuss their performance, Housing needs to do more to verify the information provided.

Annual Audited Financial Statements

The contract did not specify that an independent Certified Public Accountant (CPA) had to complete the audited financial statements. Dunlap used their internal CPA to complete the reviews. Housing contracted with Novogradac & Company, LLP (Novogradac), on July 1, 2022, to conduct independent financial audits of their affordable housing properties. We requested copies of the financial audits for fiscal

years ending June 30, 2021, and June 30, 2022, to determine if Housing received the reports and followed up on outstanding items, if any.

Annual Audited Financial Statement Submissions

Reporting Period	Due Date	Date Submitted
Jul 1, 2020 – Jun 30, 2021	July 31, 2021	November 4, 2021
Jul 1, 2021 – Jun 30, 2022	July 31, 2022	Not Received

Housing did not receive audited financial statements.

Housing did not have clearly defined procedures for tracking the annual financial statements. Audited financial statements ensure that the Contractor reported revenue accurately.

The Management Plans align with contract terms.

We reviewed each contract to confirm that the contractual language prevails over any discrepancies between the contract terms and the management plans. The Law Department (Law) informed the Contractor that if there is a discrepancy between the contract and the Management Plan, the contract takes precedence. The Contractor agreed in writing with Law’s decision. The contracts incorporate language that effectively prioritizes the contract requirements over the Management Plan.

Recommendations

- 2.1 Create and document procedures to ensure the Contractor meets performance requirements and submits required reports on time and with all necessary information.
- 2.2 Work with Novagradac to obtain audited financial statements for fiscal year 2022.

3 – Inspections

Background

The Contractor is responsible for the day-to-day management of the properties and for repairs to keep the properties in a decent, safe, and sanitary condition. Housing is required to perform annual property inspections to ensure that the properties meet The Department of Housing and Urban Development (HUD) Housing Quality Standards and/or Uniform Physical Condition Standards and Housing's requirements. Housing must also perform annual file inspections to ensure that the Contractor maintains accurate files and that properties are rented to eligible residents. The contract contains physical inspection and file checklists that must be completed for each property annually.

We interviewed Housing staff and tested inspection reports from July 1, 2022, through November 30, 2023, to determine whether annual physical and file inspections occurred as required.

Results

Housing did not conduct file inspection reviews of each property at least annually.

We interviewed Housing staff to understand their processes for completing the file reviews required by the contracts. Housing utilized an outside vendor to review the case files. We obtained a list of file compliance inspections completed by the vendor between July 1, 2022, and November 30, 2023.

The vendor conducted three file inspection reviews between July 1, 2022, and November 30, 2023. Thirteen properties did not receive a file inspection in 2022 or 2023. The vendor did not use the file inspection checklist as required by the contract. As a result, the inspections completed did not encompass all requirements specified in the contract. Not conducting annual file inspections increases the risk of renting affordable housing units to ineligible residents.

Housing did not conduct physical inspections of each property at least annually.

We interviewed Housing staff to understand their processes for completing annual physical property reviews. We tested Housing's inspection files to determine if staff inspected each property yearly using the physical checklist required by the contract.

Housing Physical Inspections Completed in 2022 and 2023

Property	2022 Physical Inspection Completed	2023 Physical Inspection Completed
Ambassador West	No	No
Camelback Properties	No	Yes
Cypress Manor	No	Yes
Desert Meadows	Yes	No
Foothills Court	No	Yes
Foothills on the Preserve	Yes	No
La Cascada I	Yes	No
La Cascada II	Yes	No
Paradise Greens	No	Yes
Paradise Village	No	Yes
Red Mountain Springs	No	No
Reflections on Portland	No	No
Sahuaro West	No	Yes
Sand Dollar	Yes	No
Windrose Villas	No	No
Yale Court	No	No

Housing did not conduct all required annual physical property inspections.

Housing did not conduct physical property inspections in 2021 due to the pandemic. In 2022, Housing conducted 5 of the required 16 physical inspections (31%), and in 2023, staff conducted 6 of the required 16 physical inspections (38%). Staff did not inspect five properties in either 2022 or 2023. The 11 inspections completed in 2022 and 2023 did not cover the minimum requirements on the physical inspection list. Physical inspections of affordable housing properties are critical to ensure the Contractor keeps the properties safe and livable.

Recommendations

- 3.1 Create written, well-defined procedures to ensure that physical and file inspections of each property are conducted using the checklist at least annually. The procedures should include timelines and responsible parties.

Scope, Methods, and Standards

Scope

We evaluated the effectiveness of Housing's monitoring of its contracts for management of Affordable Housing. We reviewed monthly financial statements, reports, and bank reconciliations as well as weekly narratives for January and October 2023. We also reviewed annual physical and file inspections as well as other required annual reports for 2022 and 2023.

The internal control components and underlying principles that are significant to the audit objectives are:

- Control Environment
 - The oversight body should oversee the entity's internal control system.
- Control Activities
 - Management should design control activities to achieve objectives and respond to risks.
- Monitoring Activities
 - Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

Methods

We used the following methods to complete this audit:

- We interviewed Housing Staff.
- We reviewed and tested Contractor reports submitted to Housing.
- We analyzed and tested budgets, financial statements, reconciled bank statements, and audited financials.
- We tested physical and file inspections of the Affordable Housing properties.

Unless otherwise stated in the report, all sampling in this audit was conducted using a judgmental methodology to maximize efficiency based on auditor knowledge of the population being tested. As such, sample results cannot be extrapolated to the entire population and are limited to a discussion of only those items reviewed.

Data Reliability

We assessed the reliability of Contractor reported revenue data by (1) performing electronic testing, (2) interviewing agency officials knowledgeable about the data. This data was used for background information, we did not rely on it for the purposes of this audit.

Standards

We conducted this performance 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 findings and conclusions based on our audit objectives. Any deficiencies in internal controls deemed to be insignificant to the audit objectives but that warranted the attention of those charged with governance were delivered in a separate memo. We are independent per the generally accepted government auditing requirements for internal auditors.