



**U.S. DEPARTMENT OF HOUSING  
AND URBAN DEVELOPMENT**

**OFFICE OF MULTIFAMILY HOUSING  
ASSISTANCE RESTRUCTURING**

**MARK-TO-MARKET PROGRAM**

**FINAL REPORT  
ON  
COMPLIANCE AUDITS AND AGREED-UPON PROCEDURES REVIEWS  
OF  
PARTICIPATING ADMINISTRATIVE ENTITIES  
FOR THE YEAR ENDED MAY 31, 2003**

**January 23, 2004**

**OFFICE OF MULTIFAMILY HOUSING ASSISTANCE  
RESTRUCTURING  
MARK-TO-MARKET PROGRAM**

**MANDATORY DATA**

Name of Contractor:	Regis & Associates, PC
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## INTRODUCTION

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### Introduction

The Office of Multifamily Housing Assistance Restructuring (OMHAR), an office within the Department of Housing and Urban Development, engaged Regis & Associates, PC to perform agreed-upon procedures (AUP) reviews and special purpose compliance audits of Participating Administrative Entities (PAEs). The purpose of these assessments was to evaluate the performance of Participating Administrative Entities in the Mark-to-Market (M2M) Program in accordance with the Operating Procedures Guide (OPG), the Portfolio Restructuring Agreement (PRA), and the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA).

In performing this engagement, we visited 17 PAEs and tested 145 Full restructurings. We conducted six compliance audits and eleven AUP reviews. We performed 37,120 test procedures and identified 373 occurrences of noncompliance. Of the 373 occurrences, 157 were identified in the compliance audits and 216 were identified in the AUP reviews. We reported these findings to OMHAR and the PAEs upon completion of each engagement.

Based on a 99% confidence level of the results, we concluded that the PAEs are substantially adhering to the restructuring requirements of the M2M Program's OPG, the PRA, and the MAHRA on a nationwide basis. However, we noted instances of noncompliance which are reported in the *Recommendations* section of this report. Of particular significance was a finding of noncompliance with the statutory requirement by MAHRA for the Owner's Evaluation of Physical Condition Assessment. Further, we conclude that OMHAR has been successfully monitoring the nationwide restructuring activities.

## EXECUTIVE SUMMARY

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### Overview

The Office of Multifamily Housing Assistance Restructuring (OMHAR), an office within the Department of Housing and Urban Development, engaged Regis & Associates, PC to perform agreed-upon procedures (AUP) reviews and special purpose compliance audits of Participating Administrative Entities (PAEs). These assessments, which supplement OMHAR's oversight activities, evaluate the performance of Participating Administrative Entities in the Mark-to-Market (M2M) Program.

The AUP reviews required the performance of test procedures agreed to by OMHAR. The compliance audits required an assessment of the risks associated with PAE noncompliance, an evaluation of the PAE internal controls, and the performance of audit procedures. The objective of both engagements was to determine whether the PAEs were operating in accordance with the M2M Program's Operating Procedures Guide (OPG), the Portfolio Restructuring Agreement (PRA), and the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA). Our test work was performed on a statistically selected sample of 17 PAEs and 145 assets in OMHAR's M2M Program portfolio. Six of the PAEs received compliance audits and eleven received AUP reviews. Our engagement covered the period of June 1, 2002 to May 31, 2003.

We designed and performed compliance audit procedures to test the six PAEs' compliance with the significant provisions and requirements of OMHAR regulations. As a part of our design of these compliance audit procedures, we identified and correlated the relevant sections of 24CFR§401 to the requirements of the OPG, the PRA, and the MAHRA. We applied the procedures documented in OMHAR's *Agreed-Upon Procedures Workplan Checklist* to test the remaining eleven PAEs' compliance with applicable M2M Program requirements. These procedures were designed to obtain reasonable assurance that the PAEs were executing the restructuring process in accordance with the requirements of the M2M Program.

Under the M2M Program, an asset restructuring comprises a series of tasks that a PAE must undertake. We tested these tasks (also referred to as attributes) for completeness and organization of the 3 main product files, procedural compliance with 11 processes, adherence to procurement policies, and accuracy of event dates, as described in the Statement of Work. A detailed description of the

attributes and the results of the findings are listed in the *Nationwide Results* section and Appendix D of this report. This technical approach facilitated not only the determination of compliance with the OPG, the PRA, and the MAHRA but also the identification of weaknesses that might adversely affect a PAE's performance and reporting relating to the M2M Program.

We projected the results of our tests to the asset and the PAE population as a whole. The cumulative results of our test work provide a significant perspective on the PAEs' compliance with the requirements of the restructuring process, as articulated in the laws, regulations, and guidelines for the M2M Program. In addition, they provide a perspective on the adequacy of OMHAR's monitoring of the M2M Program.

Based on the attributes tested, we estimate that timeline reporting had a compliance rate of 87%, project files products had a compliance rate ranging from 95% to 100% and procurement process had a compliance rate of 96%. The compliance rates identified above indicate that the PAEs are substantially adhering to the requirements of the OPG, the PRA, and the MAHRA on a nationwide basis. They further indicate that OMHAR is effectively monitoring the PAEs' restructuring activities. The results of the tests performed indicate occurrences of noncompliance with the OPG, the PRA, and the MAHRA based on the provisions of 24CFR§401. These occurrences of noncompliance relate to the procurement process, incomplete project files, and stipulated timelines in the restructuring process.

We conducted our fieldwork from June 2003 through November 2003 in accordance with *Government Auditing Standards*, *Generally Accepted Auditing Standards*, the procedures referenced in the OPG, the PRA, and the *AUP Workplan Checklist* developed by OMHAR. At the conclusion of each field visit, Regis & Associates, PC provided OMHAR with an individual report detailing the results of the AUP and compliance audits performed for each of the 17 PAEs. This final report presents the nationwide results of our work. It provides a brief overview of the Mark-to-Market Program, describes our execution of the AUP reviews and compliance audits, and summarizes the results, by review category, with a statistical summary. Our report concludes with recommendations designed to enhance the efficiency of the Program's operations.

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## Results in Brief

Although the results of our test work revealed management practices and conditions that could be improved to enhance the efficiency and effectiveness of the Program, we noted overall general compliance with the M2M Program requirements. Moreover, we also noted a willingness of OMHAR's management and the PAEs to improve the efficiency and effectiveness of the M2M Program management.

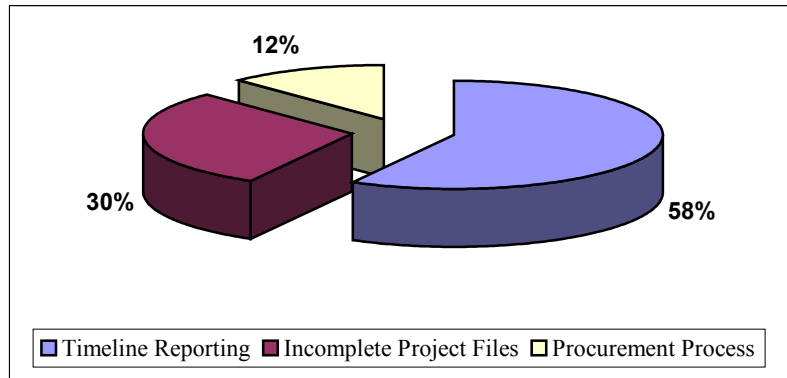
In performing this engagement, we visited 17 PAEs and tested 145 Full restructurings. Our test work consisted of conducting six compliance audits and eleven AUP reviews. We performed 37,120 test procedures and identified 373 occurrences of noncompliance. We identified 157 occurrences in the compliance audits and 216 occurrences in the AUP reviews. We reported these findings to OMHAR and the PAEs upon completion of each PAE visit.

In this report, we present the overall results of our work and a projection to the entire population. The projected results offer a perspective on the PAEs' compliance with the laws, regulations, and guidelines of the M2M program. Our projected results indicate that, based on a 99% confidence level, the PAEs are in substantial compliance with the requirements of the M2M Program as listed in the *Nationwide Results* section and Appendix D.

We have classified the occurrences of noncompliance into three classes of program risk. These risk classes are *Reporting Timelines*, *Project File Products*, and *Procurement Process*. They are discussed in the *Results* section of this report.

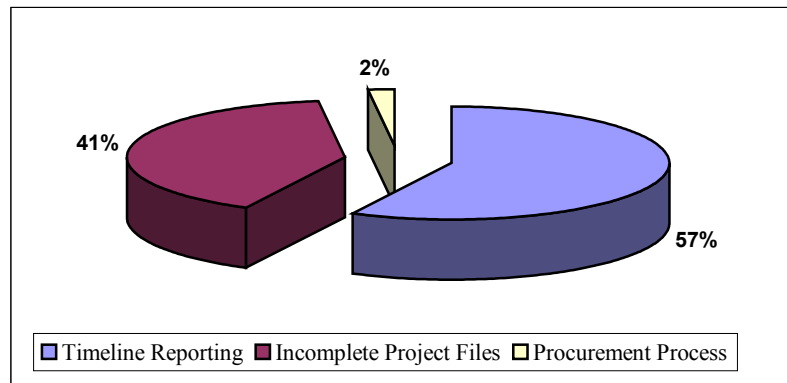
The overall results of our test work indicate that the predominance of findings relates to the completion of restructuring tasks within the OPG and PRA specified timelines. These findings represent a financial cost to OMHAR because Section 8 rent subsidies, in many cases, are continued at above-market rates until a plan reaches the stage of completion. The second most frequent group of findings relates to missing documentation in the project files. Generally, the missing documents provide independent support for restructuring plan assumptions or may represent agreement of parties to various elements of the plan. The remaining findings relate to the failure of PAEs to follow the procurement procedures prescribed in the PRA. The procurement failures generally stem from the PAEs' inadequate documentation of the results of their procedures. We have illustrated the distribution of findings for the six compliance audits in Figure 1 and the eleven AUP reviews in Figure 2, below.

**Figure 1: Analysis of Compliance Audit Findings**



As presented in Figure 1 above, of the 157 occurrences of non-compliance, 91 (58%) relate to Reporting Timelines, 47 (30%) relate to Incomplete Project File Products and 19 (12%) relate to the Procurement Process<sup>1</sup>.

**Figure 2: Analysis of AUP Review Findings**



Similarly, the analysis in Figure 2 above indicates that of the 216 occurrences of non-compliance, 124 (57%) relate to Reporting Timelines, 88 (41%) relate to Incomplete Project File Products and 4 (2%) relate to the Procurement Process<sup>1</sup>.

We present further details of these findings and the associated risks in the *Review Results* section of this report.

<sup>1</sup> Procurement failures are measured at the PAE level.



## BACKGROUND, OBJECTIVES, & SCOPE

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### Background

As part of its housing mission, the Department of Housing and Urban Development (HUD) is charged with increasing the availability of decent, safe, and affordable rental housing nationally. Over the past years, the cost of rental housing has increased significantly, and a considerable percentage of low and very-low-income renters have been forced to spend a disproportionate amount of their income on basic housing needs.

In order to address this problem and to ensure the affordability of rental housing for low-income households, HUD administers three major rental assistance programs<sup>2</sup> that collectively subsidize the housing costs for more than four million eligible Americans. These three basic rental assistance programs are the tenant-based assisted housing<sup>3</sup>, project-based assisted housing<sup>4</sup>, and public housing programs that provide the most direct means of ensuring affordable rental housing for low-income families. Besides ensuring the affordability of rental housing, the *Project-Based Section 8 Program* also increases the availability of affordable rental housing for low-income families. Additionally, in support of this objective, the Federal Housing Administration (FHA) contributes substantially to the supply of affordable housing by providing financing support for multifamily rental housing by insuring loans and risk-sharing mortgages.

More than 25 years ago, in an effort to spur the construction of affordable housing and encourage private owners to participate in its *Project-Based Section 8 Program*, HUD entered into long-term contracts with property owners that provided for annual rent increases. These increases were automatic regardless of prevailing market rents. The original housing rental subsidy contracts are expiring on thousands of privately owned multifamily properties with FHA-insured mortgages. As a result of the automatic rent increases under the Section 8 Program,

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<sup>2</sup> Under HUD's rental assistance housing programs, tenants are required to pay 30 percent of their income towards rent, with HUD subsidizing the balance of the rental payment.

<sup>3</sup> Authorized by Section 8 of the Housing Act of 1937. Also known as the *Section 8 Housing Choice Voucher Program*. This program is administered through state and local intermediary housing agencies to provide families with vouchers that they can use to rent housing in the private market.

<sup>4</sup> Authorized by Section 8 of the Housing Act of 1937. Also known as the *Project-Based Section 8 Program*. This program links rent subsidies directly to housing units and provides project-based rental assistance directly to multifamily project owners.

many of these properties charge rents at amounts higher than prevailing market rent. This results in excessive expenditures of funds for HUD's Section 8 Program. To help ensure that the federal taxpayer is not paying more for this program than the marketplace requires, the Mark-to-Market (M2M) Program was created to reduce federal spending on housing subsidies. The reduction is accomplished through restructuring, making it financially feasible for multifamily properties currently charging rents greater than comparable market rents to survive and continue to offer quality, market-competitive housing at comparable market rents.

The Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) established the M2M Program as a vehicle for restructuring multifamily properties insured by the FHA when the existing housing assistance contracts expire. The Office of Multifamily Housing Assistance Restructuring (OMHAR) administers the M2M Program and, as such, has many responsibilities, including the oversight and monitoring of the restructuring activities. In keeping with HUD's mission and its objective of increasing the availability of decent, safe, and affordable rental housing, the major goals of the M2M Program are:

- *Social*: Preserving affordable housing stock by maintaining the long-term physical and financial integrity of privately owned, HUD subsidized rental housing insured by FHA;
- *Economic*: Reducing the long term project based Section 8 rental assistance costs and reducing the cost of insurance claims paid by FHA; and
- *Administrative*: Establishing a nationwide network of locally-based PAEs to administer the M2M Program, promoting greater operating and cost efficiencies in the Section 8 assisted properties, and addressing problem properties by terminating relationships with owners who violate Program agreements and requirements.

When Section 8 contracts at above-market rents expire, OMHAR reduces rents to market levels and, where needed, restructures the existing mortgage debt to levels supportable at the lower rents. MAHRA requires OMHAR to solicit and select capable organizations, referred to as Participating Administrative Entities (PAEs), to assist in the restructuring process. The PAEs were selected through a qualifying process and are classified as either Public or Private (Non-Public) entities. The Public PAEs comprise state and local housing finance agencies, and the

Private PAEs are non-profit and for-profit entities contracted by OMHAR to perform restructurings on eligible properties in the states not within the state and local housing finance agencies' jurisdictions. The PAEs' duties are restricted to restructuring activities pursuant to a Portfolio Restructuring Agreement (PRA) between OMHAR and each PAE. The PAEs develop restructuring plans to determine appropriate market rents, identify any improvements necessary for the property to become competitive in the marketplace, and identify methods of restructuring the finances of the property to make operating at market rents financially feasible. They also help to reduce the Section 8 subsidy costs and the potential for FHA insurance claims.

OMHAR is responsible for the oversight, evaluation, and monitoring of the PAEs to ensure compliance with the M2M Program. To achieve this objective, OMHAR has developed the M2M Program Operating Procedures Guide (OPG) that sets forth the uniform process for restructuring FHA-insured Section 8 housing projects. In addition, OMHAR has also developed the M2M Program's *Agreed-Upon Procedures Checklist* as a tool for evaluating the PAEs adherence to the requirements of the OPG, the PRA, and the MAHRA. OMHAR also relies on the results of other audits for the evaluation of the PAEs, such as OMB Circular A-133 Audits, Federal Contract Audits, and other reviews. Finally, OMHAR retains independent auditors to evaluate and report on the PAEs' adherence to the requirements of the M2M Program.

There are two major types of restructuring transactions - a mortgage debt restructuring transaction (Full) and a rent restructuring transaction (Lite).

Mortgage debt-restructuring transactions, known as "Fulls", occur when the PAEs develop restructuring plans that include reduction of rents to market levels and restructured mortgage financing. These plans are approved by OMHAR when all the established criteria are satisfied. The Full mortgage debt restructuring also involves a thirty-year Use Agreement.

Rent restructuring transactions, known as "Lites", occur when the PAEs develop restructuring plans that reduce rents to market levels without refinancing the mortgage debt. A Use Agreement is not required for Lites. OMHAR approves the restructurings once it determines that the long-term physical and financial integrity of the property would not be jeopardized.

In its July 2001 *Report to Congressional Committees*, the U.S. General Accounting Office reported OMHAR's projection that the M2M program would save the federal government \$563 million over 20 years on properties that were restructured as of June 15, 2001. Through October 2003, the PAEs completed approximately 2,011 deals. H.R. 3061/Public Law 107-116 extended OMHAR through September 30, 2004. It is anticipated that the PAEs will complete an additional 540 restructurings in that period.

To obtain a more comprehensive assessment of the PAEs' activities, OMHAR engaged Regis & Associates, PC to perform eleven Agreed-Upon-Procedures (AUP) reviews and six compliance audits of PAEs to enhance its oversight and evaluation of the M2M program. This report documents the consolidated work performed and the results thereof.

## Objectives, Scope, and Methodology

OMHAR engaged Regis & Associates, PC to perform compliance audits and AUP reviews of PAEs to enhance its oversight and evaluation of these organizations under the M2M Program. The focus of our work was to determine whether the PAEs complied with the major requirements of the PRA, the OPG, and the significant provisions of applicable laws and regulations during the period June 1, 2002 to May 31, 2003. Regis & Associates, PC was not engaged to form a judgment as to the economic benefit or worth of the restructuring transactions that have been executed. Moreover, our report does not provide a legal determination of PAEs' compliance with the requirements identified above. Our work was designed to test procedural compliance with these requirements. In addition, the evaluation addresses the following secondary objectives:

1. The determination of the completeness and organization of the product files as required by the PRA and OPG.
2. The determination of the completeness of data and procedural compliance with the processes required by the PRA and OPG.
3. The determination of the accuracy of the event dates in the PAEs' documents and the MIS tracking reports.

In the process of selecting PAEs and assets for testing, we applied stratified random sampling techniques. The assets at a given PAE constituted a single stratum. We constructed simple random samples from a representative subset of the PAEs in the population.<sup>5</sup> We determined that visiting 17 PAEs and sampling 145 restructuring transactions would provide sufficient data to compute average exceptions with a 99% confidence interval. Our selected sample of 145 transactions comprised both "Closed" and "Action Other Than Closing" (AOTC) Full transactions.

We reviewed applicable laws, implementing regulations, policies, and pertinent documents in order to obtain an understanding of the M2M Program, its requirements, and the PAEs' and OMHAR's responsibilities. We reviewed *OMHAR's Agreed-Upon Procedures Workplan Checklist* and designed additional procedures for the compliance audits.

We coordinated our fieldwork with OMHAR and interviewed the

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<sup>5</sup> See Sampling Methodology Document at Appendix A

PAEs' officials designated as our contacts for the AUP reviews and compliance audits. We designed these interviews to obtain an understanding of the PAEs' policies and procedures for internal control, procurement, training, and file maintenance that affect their operations in the M2M Program. We requested that the PAEs provide documents and information on the performance of the required restructuring activities for the selected assets. We obtained confirmation that the documents and files provided were accurate and complete. The data requested and evaluated for compliance included:

1. Documents constituting the credit file, contract file, and closing file.
2. Documents detailing the eleven primary processes in the PAEs' restructuring function; namely, training, conflict of interest notifications, owner eligibility reviews, tenant/owner meetings and required notices, due diligence/data collection, underwriting, restructure approvals, closing, documentation distribution and conversion, procurement processes/oversight of third party contractors, and OMHAR invoicing.
3. Documents detailing the dates that events occurred as indicated in the PAEs' file documents and the MIS tracking reports.

We reviewed and tested the restructuring records and other evidential matter attesting to the PAEs' restructuring activities. In addition, we assessed the PAEs' risk of noncompliance, evaluated their internal controls, and performed other audit procedures in conducting the six compliance audits. The objectives of the audits were to test the PAEs' compliance with the significant provisions of 24CFR §401, to identify instances of noncompliance, and to provide reasonable assurance of compliance with the M2M Program.

At the completion of fieldwork, we briefed OMHAR and the PAE officials on the results of our work. Additionally, we prepared individual report for each of the 17 PAEs presenting the findings and recommendations. The Nationwide Results presented in this report represent the projected results of the test work from our sample of 17 PAEs and 145 Assets. We conducted these reviews and audits from June 2003 through November 2003. Our work was conducted in accordance with *Government Auditing Standards and Generally Accepted Auditing Standards*.

## RESULTS

### PAE Profile

As illustrated in Table 1 below, we selected 17 PAEs for our review - six for compliance audits and eleven for AUP reviews. We selected a sample of 145 assets comprising 57 and 88 transactions for the compliance audits and AUP reviews, respectively.

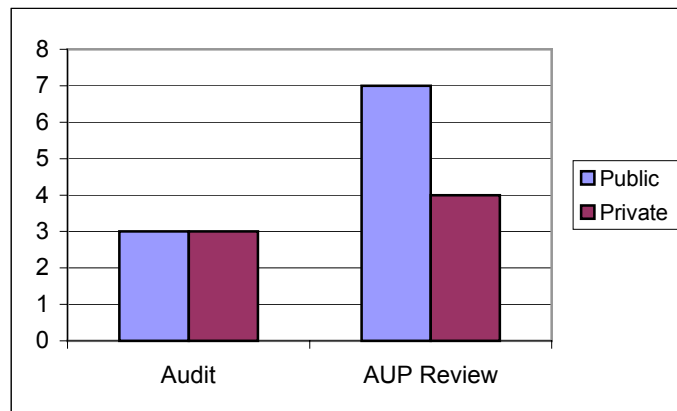
**Table 1: Samples Selected and Reviewed Statistics**

	Type of Compliance Tests		Total
	Audit	AUP Review	
PAEs Reviewed	6	11	17
Full Assets Reviewed	57	88	145
Occurrences of Noncompliance	157	216	373
Population of Full Assets	214	341	555

The work performed, and the results thereof, are based on asset sample coverage of approximately 25%.<sup>6</sup>

Our PAE sample includes ten public and seven private PAEs. As illustrated in Figure 3 below, we performed compliance audits of three public and three private PAEs. We performed AUP reviews of seven public and four private PAEs.

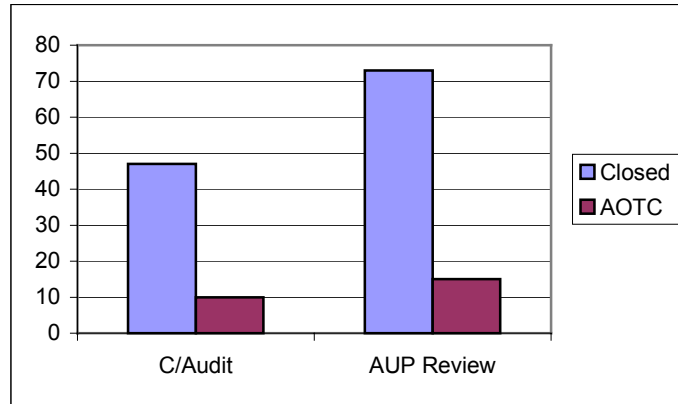
**Figure 3: Types of PAEs Tested**



<sup>6</sup> See Sampling Methodology Document at Appendix A

Of the 145 Full assets tested, 120 were “Closed” and 25 were “Action Other Than Closing ” (AOTC). As a part of the compliance audits, we tested 47 “Closed” assets and 10 “AOTC” assets. As a part of the AUP reviews, we tested 73 “Closed” assets and 15 “AOTC” assets. These distributions are illustrated in Figure 4.

**Figure 4: Full Restructuring Assets Tested**



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## Review Findings

In our audits and reviews, we noted management practices and conditions that could be improved to enhance the efficiency and effectiveness of the Program. We reported our findings and other matters for consideration to OMHAR and each PAE in the individual review reports.

For this report, we have classified the findings and their frequency into three classes of noncompliance as identified below:

- Class 1 - Findings of Noncompliance in the Reporting Process
- Class 2 - Findings of Noncompliance in the Project Files
- Class 3 - Findings of Noncompliance in the Procurement Process

We report these findings based on the nature of the engagement in which they were identified.



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## Class 1 – Reporting Timelines

Class 1 comprises findings of noncompliance with applicable M2M Program policies for stipulated timelines. These timelines relate to the performance of certain required activities in the restructuring process. The results of our test work indicated that the overall compliance rate was 86.7%. Alternatively, this equates to a noncompliance rate of 13.3%. As shown in Table 2, the frequency of noncompliance with stipulated timelines ranged from 4 to 80 occurrences. The distribution of these findings into the compliance audit and AUP reviews is presented in Figure 5.

While all the findings in this Class relate to timing requirements, five of these findings relate to specific requirements, each of which has a significantly different effect on the restructuring process.

The failure to hold the 2<sup>nd</sup> tenants meeting not less than 10 days prior to submitting the restructuring plan deprives tenants of their final opportunity to review the plan and present any additional issues for inclusion. It is HUD's and OMHAR's policy to accord tenants the maximum opportunity for consideration of their comments. The 2<sup>nd</sup> tenants meeting requirement is an OPG requirement, designed to accord the PAE ample time to consider any final tenant concerns, modify the plan as necessary, and submit the plan to OMHAR in a timely manner.

The closing process for a restructuring generates a large number of legal documents necessary to define each party's rights and obligations and to record them with the local or state governments. To close a transaction promptly, it is necessary for the PAE to assemble the final closing documents and distribute them to the appropriate parties within the 65-day limit as specified in the OPG. PAEs may distribute recorded documents later, provided they include a copy of the non-recorded document in the closing docket. Failure to provide the Hubs and Program Centers with key provisions of the transaction would limit their ability to properly execute their role in project management.

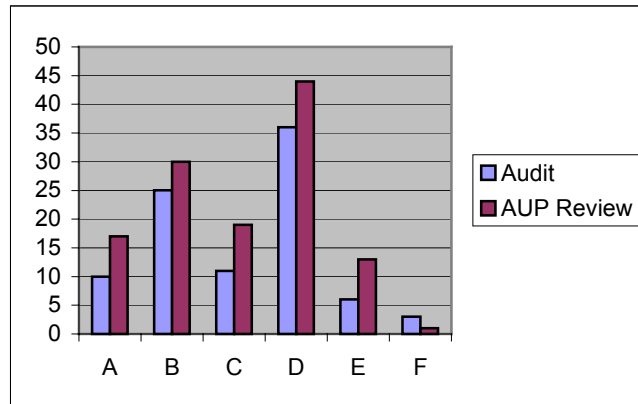
The failure to close a property within the 365-day limit may necessitate additional Section 8 expenditures until the restructuring is complete. HUD may continue such payments for up to one year.

The PRA requires the PAE to complete the due diligence within the 150-day limit and submit the restructuring plan within the 210-day limit of the date that the property was assigned for restructuring. Failure by the PAE to meet the specified timelines constitutes a default under the agreement and undermines the effectiveness and efficiency of the M2M Program. It was noted that some delays resulted from the flow of documentation from the Owner.

**Table 2: Class 1 – Reporting Timelines Findings**

Stipulated Timelines	Findings of Noncompliance
<b>OPG Timeline Requirement</b>	
<b>A:</b> PAEs did not hold the second tenant meeting at least 10 days prior submission of the restructuring plan	27
<b>B:</b> PAEs did not distribute the closing docket within 65 days of transaction closing	55
<b>PRA Timeline Requirement</b>	
<b>C:</b> PAEs did not close the transaction within 365 days from the assignment date	30
<b>D:</b> PAEs did not submit plan within 210 days from the assignment date	80
<b>E:</b> PAEs did not complete due diligence within 150 days from the assignment date	19
<b>F:</b> Other – default in miscellaneous timeline reporting with frequency less than 5	4
<b>Total</b>	<b>215</b>

**Figure 5: Class 1 – AUP Review and Compliance Audit Reporting Timelines Failures**



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## Class 2 – Project File Products

Class 2 comprises findings of noncompliance with M2M Program policies and procedures relating to restructuring documentation. OMHAR requires PAEs to retain certain documents in the project files for each asset processed. The results of our test work indicated that the PAEs failed to comply with eight requirements for documentation. As shown in Table 3, of the 145 assets tested, the frequency of noncompliance for each documentation requirement ranged from less than 5 to 44 per category of documentation. The frequency of the findings, by engagement type, is presented in Table 3 and Figure 6 below.

The rate of compliance for each OMHAR requirement in this Class of findings was over 96%, with the exception of the requirement for Form 4.7 Physical Condition Assessment (PCA) Adoption. As noted in Table 3 below, this requirement represents the most significant finding in this category. Although 11 of the 17 PAEs reviewed failed to meet the Form 4.7 PCA requirement, the predominance of the occurrences relate to one PAE and one Owner with multiple properties.

The lack of an Owner's evaluation of the physical condition or adoption of the PAE's PCA by signing the Form 4.7 results in a failure to meet the statutory requirement in MAHRA. Many Owners will not incur the costs associated with performing their own physical assessments of property condition, thereby implicitly relying on the PAE's PCA. The PAE's PCA is performed early in the restructuring process, and its findings serve as the basis for determining and scheduling the capital improvements deemed necessary to maintain the property. These costs are included in the restructuring plan to ensure that the Owner formally acknowledges the current property condition, along with the plan to address any repair or replacement requirements over the life of the Use Agreement.

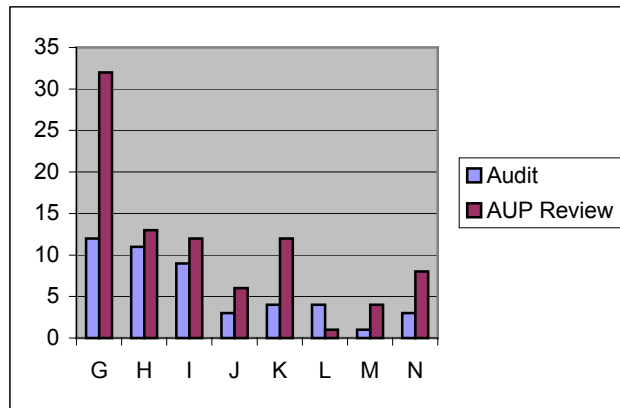
It was noted that Owners are reluctant to accept the PCA as it does not always address matters to their specification. In some cases, enforcing the execution of the Form 4.7 is sometimes accomplished by an Owner signing the Restructuring Commitment and agreeing to furnish it immediately preceding the Closing. Although OMHAR included this process in the new version (01/31/03) of the Restructuring Commitment, the Owners still failed to execute the Form 4.7.

The other findings of noncompliance in this Class, which represent the remaining seven requirements, relate to missing documentation for miscellaneous activities in the restructuring plan, owner eligibility, tenant/owner meeting and invoicing. These are documents necessary to define each party's rights and obligations in the restructuring process. Failure to complete them undermines the efficiency and effectiveness of the M2M Program.

**Table 3: Class 2 – Project File Product Findings**

Project File Products	Findings of Noncompliance
<b>G:</b> No documentation of the owner's evaluation of the property's physical condition or adoption of the PAE's PCA	44
<b>H:</b> No documentation of the owner's loan history	24
<b>I:</b> No documentation of related parties	21
<b>J:</b> No documentation of notification to tenants upon completion of restructuring plan	9
<b>K:</b> No documentation of notification to local government upon completion of restructuring plan	16
<b>L:</b> No documentation of request for information from HUD	5
<b>M:</b> No supporting documentation of billings for work performed	5
<b>N:</b> Other - no documentation for miscellaneous restructuring activities with a frequency of less than 5	11
<b>Total</b>	<b>135</b>

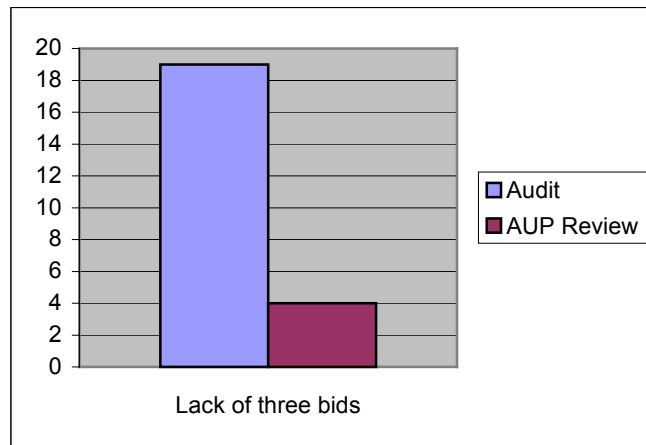
**Figure 6: Class 2 – AUP Review and Compliance Audit Project File Product Failures**



### Class 3 – Procurement Process

Class 3 comprises findings of noncompliance with applicable M2M Program policies and procedures for procurement. OMHAR requires PAEs to obtain at least three bids in their procurement process or obtain prior approval for any alternative procurement procedures that they adopt. Our results indicated that five PAEs failed to comply with this requirement in 23 of the 145 assets tested<sup>7</sup>. Nineteen of these occurrences were identified in the compliance audits, and four were identified in the AUP reviews as noted in Figure 7 below.

**Figure 7: Class 3 – AUP Review and Compliance Audit Procurement Failures**



<sup>7</sup> Procurement failure is at PAE level and one failure constitutes multiple occurrences of assets under the PAE.

## Nationwide Results

The results of our review of the sampled PAEs and assets are projected to the entire PAE and asset populations. The cumulative results of our test work offer significant perspective on the PAEs' compliance with the laws, regulations, and guidelines of the M2M Program.

We present the projected results according to the classes of findings and their related attributes. Based on the attributes tested, we estimate that Timeline Reporting had a compliance rate of 87%, Project Files Products had a compliance rate ranging from 95% to 100% and Procurement Process had a compliance rate of 96%. The compliance rates identified above indicate that the PAEs are substantially adhering to the requirements of the OPG, the PRA and the MAHRA on a nationwide basis. They further indicate that OMHAR has been effectively monitoring the PAEs' M2M restructuring activities.

A description of each attribute tested and the projected results is detailed below:

### Class 1 – Reporting Timeline Process:

- Attribute: Timing  
We verified the accuracy of the reported critical dates. We estimate that the exception rate for this attribute is 12.32%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 13.33%.

### Class 2 – Project File Products:

- Attribute: Restructuring Plan Package  
We verified the existence of narrative on PAE's conclusion on ownership, market rents, net operating income, mortgage information and evaluation of the physical condition of the property. We estimate that the exception rate for this attribute is 4.78%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 5.33%.
- Attribute: Tenant and Community Comments  
We confirmed tenant and community comments for 1<sup>st</sup> and 2<sup>nd</sup> tenant meetings. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Supporting Materials  
We confirmed that the PAE documented information on rental assistance and assessment plan and discussions of waivers. We estimate that the exception rate for this attribute is 0%; and, in

addition, we are 99% confident that the true exception rate as a whole is not more than 0%.

- Attribute: Information Form 5.2  
We verified the existence of documentation relating Form 5.2 package, three years of financial statements, appraisal, PCA, restructuring commitment, FHA and mortgage firm commitment. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Owner's Package  
We verified the existence of ownership documentation including loan history statement, related party check, insurance, major repairs, subordinate debt and use restriction and agreements. We estimate that the exception rate for this attribute is 3.63%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 4.28%.
- Attribute: Other  
We verified the existence of miscellaneous restructuring documentation including asset information from HUD, code compliance, expense data, property management, evaluation on management, loan application and evidence of recommendation, approval or rejection of restructuring plan and commitment. We estimate that the exception rate for this attribute is 0.27%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.48%.
- Attribute: Closing File  
We verified the existence of closing file correspondences, notifications and certifications relating to closing activities. We estimate that the true exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Closing Docket  
We verified the completeness of the closing docket including the transmittal letter and documentation related to mortgage, rehabilitation funding, multifamily claims, insurance, Use Agreements, Section 8 documents, and additional documents. We estimate that the exception rate for this attribute is 0.04%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.10%.
- Attribute: Contract File

We verified the PAEs' possession of the PRA, monthly reports, conflict of interest and civil rights certifications, key contract personnel and copy of the most recent audit report. We estimate that the true exception rate for this attribute is 0.44%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.50%.

- Attribute: Training  
We confirmed the PAEs participated in technical briefings and conducted staff training. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Conflict of Interest  
We confirmed PAEs had established procedures to identify conflict of interest. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Owner Eligibility  
We verified the determination of eligibility check and notification to OMHAR. We estimate that the exception rate for this attribute is 0.34%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.34%.
- Attribute: Tenant/Owner Meetings and Required Notices  
We verified the existence of documentation related to tenant and owner communications; e.g. kick-off meetings, notices for first and second tenant meetings, notices to local government. We estimate that the true exception rate for this attribute is 2.40%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 2.61%.
- Attribute: Due Diligence/Data Collection  
We verified that the PAEs obtained the owner's documents, lender records, HUD asset management records, financial records, and local government records or determined whether they can proceed without these. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Underwriting  
We verified the existence of documentation related to the PAEs' requests for exception rent limitation waivers and discussions with the Owner, existing mortgage or proposed new lender. We estimate that the exception rate for this attribute is 0%; and, in



addition, we are 99% confident that the true exception rate as a whole is not more than 0%.

- Attribute: Mortgage Restructure Approvals  
We verified the submission and approval of the restructuring plans and commitment. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Closing  
We verified the existence of transmittal letter with supporting materials and documentation related to post closing reconciliation. We estimate that the exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.
- Attribute: Documentation Distribution and Conversion  
We verified the proper distribution of closing documents, the existence of acknowledgment letters from pertinent parties and confirmed post-closing internal review. We estimate that the exception rate for this attribute is 0.37%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.96%.
- Attribute: OMHAR Invoicing  
We verified the propriety of the PAEs' billings to OMHAR in accordance with the PRA. We estimate that the exception rate for this attribute is 0.60%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0.83%.
- Attribute: Other Reporting  
We verified the submission of semi-annual reports regarding restructuring results. We estimate that the true exception rate for this attribute is 0%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 0%.

### **Class 3 – Procurement Process:**

- Attribute: Procurement Processes  
We evaluated the PAEs' procurement process for third party contractors. We estimate that the exception rate for this attribute is 3.63%; and, in addition, we are 99% confident that the true exception rate as a whole is not more than 4.31%.

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## Conclusion

The overall results of our test work indicate that the PAEs are in substantial compliance with the restructuring requirements of the M2M Program. Therefore, we conclude that OMHAR has been monitoring the nationwide PAE restructuring activities effectively.

Although we found substantial compliance with the restructuring requirements of the M2M Program, the results of our test work identified management practices and conditions, which require consideration by OMHAR. Of particular significance was a finding of noncompliance with the statutory requirement by MAHRA for the Owner's Evaluation of Physical Condition.

These findings provide opportunities for enhancing the restructuring process. OMHAR's implementation of our recommendations would enhance the effectiveness of the PAEs' activities in the restructuring process. These recommendations are discussed below.

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## Recommendations

### **1. OMHAR Should Enforce the Requirement of Owner's Evaluation of Physical Condition or the Adoption of the PAE's PCA**

As previously stated in the *Review Results* Section of this report, there were 44 instances where an Owner's Evaluation of Physical Condition or the Owner's Adoption of the PAE's PCA (Form 4.7) was not present. The lack of an Owner's evaluation of the physical condition or adoption of the PAE's PCA by signing the Form 4.7 results in a failure to meet the statutory requirements in MAHRA.

The reason for the absence of the OMHAR Form 4.7 (Owner's Adoption of the PAE's PCA) findings was generally because the Owners failed to execute the document when required. As a result, there is a risk of increased financial cost because Owners may ultimately disagree with the PCA and cost or timing of replacement/repairs and refuse to proceed, causing the PAEs to modify the plan. This may also have implications for other elements of a restructuring.

We recommend that OMHAR enforce the requirement to ensure the receipt of Owner's evaluation of physical condition or the adoption of the PAE's PCA in the restructuring process for all transactions. OMHAR should also clearly define the point at which the Owner must execute the Form 4.7 in the restructuring process. Furthermore, we recommend that OMHAR consider making the condition in the Restructuring Commitment a one step process for the Owner's acceptance of the PAE's PCA by eliminating the subsequent submission of the Form 4.7. This change should be made after consulting with, and the concurrence of, OMHAR's counsel.

## **2. Controls Over Stipulated Timeline Events Need Strengthening**

We noted noncompliance with stipulated timelines as required by the OPG and PRA, with frequency ranging from less than 4 to 80 occurrences.

Given the impact that noncompliance with stipulated timelines can have on the efficiency and cost-effectiveness of the M2M Program, OMHAR and the PAEs should implement additional measures to promote compliance. This should include emphasizing to each PAE the importance of establishing and maintaining a strong system of internal controls designed to track the critical dates and events to ensure timely completion of those events. In addition, we recommend the inclusion of procedures for requesting extensions or waivers from OMHAR for restructuring events that are not expected to meet the stipulated timelines.

The recent implementation of an automatic notification system by OMHAR should enhance communication with the PAEs in instances where a delay is likely to occur and enforce the timelines requirements according to the PRA. The PAEs should work in collaboration with OMHAR in meeting the stipulated timelines for completing the restructurings. They should also communicate with OMHAR in advance in the event of any foreseeable delays in the process. In the event of such delays, the PAEs must obtain appropriate time waivers from OMHAR prior to exceeding the deadlines. We observed that PAEs are currently submitting waivers after the fact. OMHAR should consider implementing procedures whereby waivers are processed more timely.

## **3. Document Maintenance in the Restructuring Process Needs Improvement**

Although the OPG describes and details the required documentation that should be maintained, we noted instances where PAEs were either not maintaining files in accordance with the OPG or the documents were not completed or executed as required. These instances of noncompliance ranged from less than 5 to 24 per category of documentation.

OMHAR should stress the importance of obtaining and maintaining the required documents, as these are necessary for defining each party's rights and obligations in the restructuring process. Some of these documents should be incorporated into a checklist of items for review by OMHAR and be subjected to approval as part of the restructuring plan. OMHAR should also assess the relevance of the documents that are part of the restructuring process and modify its documentation requirements and processes accordingly.

#### **4. Procurement Requirements for Three-Bids Need to Be Enhanced.**

The PRA requires PAEs to obtain at least three bids for their procurements or employ an alternate competitive procurement process with prior approval from OMHAR. We noted 23 occurrences (represented by five PAEs) of noncompliance with this requirement. Some PAEs were unclear as to whether the requirement was for each asset and each subcontractor thereunder or whether they could use contractor pools to avoid multiple procurements for each service.

We recommend that OMHAR review the procurement regulations regarding contractors and determine whether there are more effective and allowable procedures and policies that may be implemented. This may include providing guidance to the PAEs on the minimum processes considered necessary to comply with the procurement standards.

## Other Matters

In conjunction with the performance of fieldwork on the 17 compliance audits and Agreed-Upon-Procedures reviews, we observed several matters that we believe are worthy of communication to OMHAR's management. These matters, in connection with the application of the procedures that we agreed to perform, depict varying practices by PAEs and require further consideration by OHMAR. The distribution of these matters, represented by the number of PAEs reviewed, is presented in Table 4 below, followed by recommendations.

**Table 4: Other Matters for Reporting**

Other Matters	Number of PAEs Affected
Subsidy layering review not properly documented	6
Code compliance not formally obtained	13
Easement and joint use agreement not formally obtained	7
Preliminary title report – title report obtained only at closing	7
Timeline waivers obtained after the event deadline	2

### Subsidy Layering Review Should be Formally Documented

We noted inconsistent documentation and reporting standards of PAEs' results of subsidiary layering reviews. Some PAEs did not formally document their review process in the submission to OMHAR while others merely noted that there were no subsidy layering issues to be considered. Subsidy layering review is a statutory requirement designed to prevent multiple funding sources for the same property and ensure that the property does not receive more financial assistance than required. Owners are required to disclose such funding, and the PAEs must ensure that all sources have been identified and reflected in the Source and Use Statement.

We recommend that OMHAR emphasize that the PAEs specifically report the analysis performed and whether that analysis identified any subsidy issues to be addressed in the restructuring plan. The OMHAR guidance might also suggest standardized wording to report the existence or nonexistence of subsidy layering. We also recommend that the verification of this matter be undertaken as part of transaction approval.

### Code Compliance Information Should be Adequately Documented

We noted varying PAE practices for reporting code compliance issues. In some cases, the PCA report indicated that local officials were contacted and also reported that there were no violations. However, in those cases the report typically gave no details about the agencies or individuals providing the information. In other cases, the PCA merely

reported that the inspector noted no conditions that appeared to be violations. The OPG requires PAEs to communicate with the appropriate authorities to obtain information regarding a project's compliance with applicable codes. Because building codes vary from location to location, an inspector may not be sufficiently familiar with local codes to identify all code violations by observation only. Further, property owners or managers may have attempted repairs or hidden violations from view.

OMHAR should require that PAEs obtain adequate documentation, in the form of letters or memos, from local or state authorities describing any violations unabated at the time, including a history of recent corrected violations. If PAEs delegate this task to the PCA Inspector, the PCA should clearly address code compliance in a separate section of the report to include the name of the regulatory agency contacted, individuals' titles, date, and other identifying information.

### **Preliminary Title Report and Use Restriction Should be Obtained as Part of the Due Diligence Documentation**

We noted instances where the PAEs do not obtain a preliminary title report in the initial phase of the restructuring process. On request for a title report from Owners, PAEs are sometime provided with copies from the original loan documents. Over the years, the Owners may have granted property rights such as easements to utility companies or may have had liens placed against the property for unpaid bills or taxes. These conditions may affect the project so severely as to cause OMHAR to terminate the proposed restructuring. OMHAR, however, cannot make a determination regarding title issues without information in the form of a current title report.

We recommend that OMHAR ensure that the PAEs request and obtain the preliminary title report and address any Easements and Joint Use Agreements from the Owners as a part of the due diligence phase. In the event that there are no Easements or Joint Use Agreements, the lack thereof should be formally documented in the files. We also recommend that subsequent revisions to Chapter 4-7D of the OPG incorporate guidance as provided by the Resource Desk broadcast dated 08/01/2001.

### **Timeline Waivers and MIS Reporting Processes Should be Improved**

We noted instances in which PAEs obtained time waivers after the milestone had passed. In other cases, the MIS critical data reports were not modified to indicate the processing suspension for some reassigned properties or properties placed on hold. The waivers and reassignment documents in these cases indicated the correct dates and milestones; but,

because of limitations of the MIS system, the dates could not be entered without deleting previous data on the property. Accurate reporting and adherence to established timelines are critical to ensuring that restructuring is completed efficiently and effectively.

We recommend that OMHAR emphasize PAEs' responsibility to internally monitor their progress and to request waivers in advance of the milestone and not after the past due date stipulated in the PRA. When the waiver extensions are received, OMHAR should ensure that they are processed on time and clearly indicate the extended date, number of days allowed, and the specific definition of waiver approved.

With regards to the MIS system, which supports OMHAR's management and internal and external reporting on Program statistics, we recommend that OMHAR review the MIS data fields and the parameters for entering milestones to ensure that the management reports accurately reflect the status of each restructuring. We recommend that additional input fields be added in the MIS system to facilitate end user reporting of dates pertaining to processing suspension for reassigned properties or properties placed on hold.

## Appendix A

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### Statistical Sampling Methodology

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Regis & Associates, PC retained Dr. Gary Anderson as its statistician to determine appropriate sampling processes and associated statistical techniques for the evaluation of PAE performance as a whole. Our sample selection was based on a population of 555 "Full" asset restructurings that were "Approved but Not Closed" or "Closed" between June 1, 2002 and May 31, 2003. We determined that visiting 17 PAEs and sampling 145 restructuring transactions would provide sufficient data to accurately compute average exceptions with a 99% confidence interval.

We developed a sampling methodology that would statistically support projections of the actual exception occurrences in our sample to the total population of PAEs. The methodology selected provided a dual-purpose sample that would aid in identifying internal control weaknesses and identifying non-compliance occurrences with the specific attributes required in the Statement of Work.

Rather than selecting a random sample from the asset population as a whole, which might have required visits to all PAEs and would have been inefficient and cost prohibitive, we selected a statistically valid sample of 17 PAEs for data analysis: the 12 PAEs that had both "Closed" and "Approved but Not Closed" assets and the 5 PAEs that had the most "Approved but Not Closed" assets. We determined that a simple random sample of 100 or more assets would produce confidence intervals small enough to support a statistically sound evaluation of PAE performance. We constructed a sample of 145 assets by sampling at a 25% rate from each of the 17 PAEs.

We tabulated the results of each of the procedures in the AUP checklist for each asset, consolidated them for each asset tested at each PAE, and finally consolidated the total results from all PAEs for all assets. We then arranged the results in the same order as the requirements in the Statement of Work (Products, Processes, Reporting), totaling them for each requirement.



## Appendix B

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### Listing of Selected Participating Administrative Entities

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	<b>PAE Name</b>	<b>Location</b>
1	City of Chicago, Department of Housing	Chicago, IL
2	City of Indianapolis	Indianapolis, IN
3	Colorado Housing Finance Agency	Denver, CO
4	First Housing Development Corporation	Tampa, FL
5	Foley and Judell, LLP	New Orleans, LA
6	Heskin - Signet Partnership	Denver, CO
7	Illinois Housing Development Authority	Chicago, IL
8	Indiana Housing Finance Authority	Indianapolis, IN
9	Jefferson County Assisted Housing Corporation	Birmingham, AL
10	Kitsap County Consolidated Housing Authority	Seattle, WA
11	New York State Housing Finance	New York, NY
12	North Carolina Housing Finance Agency	Raleigh, NC
13	North Dakota Housing Finance Agency	Bismark, ND
14	NW Financial Group	Jersey City, NJ
15	Ontra Inc	Austin, TX
16	Real Estate Recovery, Inc.	Herndon, VA
17	The Siegel Group, Inc	Austin, TX

## Appendix C

### PAE Report Types and Sample Selection

PAE	REPORT	Fulls	Selected Sample
City of Chicago, Department of Housing	AUP Review	2	2
City of Indianapolis	AUP Review	3	3
First Housing Development Corporation	AUP Review	37	8
Foley and Judell, LLP	AUP Review	62	13
Indiana Housing Finance Authority	AUP Review	9	5
Jefferson County Assisted Housing Corporation	AUP Review	31	7
New York State Housing Finance	AUP Review	5	3
North Carolina Housing Finance Agency	AUP Review	3	3
North Dakota Housing Finance Agency	AUP Review	2	2
NW Financial Group	AUP Review	74	18
Real Estate Recovery, Inc	AUP Review	113	24
<i>AUP Review Total</i>	11	341	88
Colorado Housing Finance Agency	Audit	5	4
Heskin - Signet Partnership	Audit	86	22
Illinois Housing Development Authority	Audit	9	4
Kitsap County Consolidated Housing Authority	Audit	10	3
Ontra Inc	Audit	52	12
The Siegel Group, Inc	Audit	52	12
<i>Compliance Audit Total</i>	6	214	57
<b>TOTAL</b>	<b>17</b>	<b>555</b>	<b>145</b>

## Appendix D

### Summary of Statistical Analysis

Attributes	Number of Assets in Population	Number of Assets in Sample	Number of Procedures Performed	Number of Exceptions	Error Rate	Confidence Intervals @99%
<b>Class 1 – Reporting Timelines</b>						
Timing	555	145	2320	215	12.32 %	(11.31, 13.33)
<b>Class 2 – Project File Product</b>						
Restructuring Plan Package	555	145	1015	44	4.78%	(4.23, 5.33)
Tenant & Community Comments	555	145	435	0	0.00%	(0.00, 0.00)
Supporting Material	555	145	435	0	0.00%	(0.00, 0.00)
Information Form 5.2	555	145	1885	0	0.00%	(0.00, 0.00)
Owners Package	555	145	1595	45	3.63%	(2.98, 4.28)
Other	555	145	5075	6	0.27%	(0.06, 0.48)
Closing File	555	145	1885	0	0.00%	(0.00, 0.00)
Closing Docket	555	145	14355	2	0.04%	(-0.02, 0.10)
Contract File	555	145	1160	5	0.44%	(0.37, 0.50)
Training	555	145	290	0	0.00%	(0.00, 0.00)
Conflict of Interest	555	145	290	0	0.00%	(0.00, 0.00)
Owner Eligibility	555	145	290	1	0.34%	(0.34, 0.34)
Tenant/Owner Meetings Required Notices	555	145	1160	27	2.40%	(2.19, 2.61)
Due Diligence/ Data Collection	555	145	1305	0	0.00%	(0.00, 0.00)
Underwriting	555	145	580	0	0.00%	(0.00, 0.00)
Mortgage Restructure Approvals	555	145	580	0	0.00%	(0.00, 0.00)
Closing	555	145	435	0	0.00%	(0.00, 0.00)
Documentation Distribution and Conversion	555	145	435	1	0.37%	(-0.22, 0.96)
OMHAR Invoicing	555	145	725	4	0.60%	(0.38, 0.83)
Other Reporting	555	145	145	0	0.00%	(0.00, 0.00)
<b>Class 3 – Procurement Process</b>						
Procurement	555	145	725	23	3.63%	(2.95, 4.31)
<b>Total</b>			<b>37120</b>	<b>373</b>		

Note: Where the number of exceptions was zero, since only a sample of transactions was selected, qualitatively it is likely that the overall percentage of errors is small.